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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

OR

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

Commission File No. 0-28830

The Metzler Group, Inc.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware | 36-4094854 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

615 North Wabash Avenue, Chicago, Illinois 60611
(Address of principal executive offices, including zip code)

(312) 573-5600
(Registrant's telephone number, including area code)

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

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

Common Stock, par value $0.001 per share
Title of Class

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

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

As of March 12, 1999, 40,488,540 shares of the Registrants common stock, par value $.001 per share ("Common Stock"), were outstanding. The aggregate market value of shares of Common Stock held by non-affiliates, based upon the closing sale price of the stock on the Nasdaq National Market on March 12, 1999, was approximately $1,511,761,828.

The Registrant's Proxy Statement for the Annual Meeting of Stockholders scheduled to be held May 19, 1999 is incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

## Item 1--Business

### General

The Metzler Group, Inc. ("We" or the "Company") is a leading provider of consulting services to energy-based and other network and regulated industries. The Company offers a wide range of consulting services designed to assist our clients as they face changing regulations, increasing competition and evolving technology. Our clients include the 50 largest investor-owned utilities, the 20 largest gas distribution companies and the 12 largest local exchange telecommunications companies in the United States, as well as other Fortune 100 companies. Our services include: (1) management consulting; (2) information technology; and (3) litigation support. Since our initial public offering in October 1996, we have increased the scope and size of our service offerings through a series of acquisitions and internal growth. We have also expanded our base of non-utility energy clients and established a presence in Europe, Asia and Australia.

We believe that several competitive factors distinguish us from other participants in the consulting industry, including:

--Established, recognized expertise and academic reputation of our consultants and affiliated experts;
--Deep-rooted client relationships supporting multiple engagements; and
--A wide range of industry-specific services that enable us to be a single-source provider of consulting services while maintaining advanced skill sets in each area.

Our growth strategy is to:

--Continue to build a complementary spectrum of consulting services;
--Leverage vertical focus to capitalize on current industry dynamics;
--Leverage existing relationships and expand our client base in both domestic and international markets;
--Continue to recruit and retain highly skilled professionals; and
--Continue to acquire consulting companies that provide complementary services or geographic presence.

At December 31, 1998, we had five principal operating subsidiaries: LECG, Inc. ("LECG"), Metzler & Associates, Inc. ("Metzler & Associates"), Peterson Consulting, L.L.C. ("Peterson"), Reed Consulting Group, Inc. ("Reed"), and Resource Management International, Inc. ("RMI"). On February 7, 1999, we acquired our sixth principal operating subsidiary, Strategic Decisions Group. Our executive office is located at 615 North Wabash Avenue, Chicago, Illinois 60611. Our telephone number is (312) 573-5600.

### Marketing and Sales

We market our services directly to mid-level and senior executives using a variety of business development and marketing techniques to communicate directly with current and prospective clients, including on-site presentations, industry seminars and industry-specific articles and other publications.

A significant portion of new business arises from prior client engagements. In addition, we expect to leverage the client relationships of firms we have acquired by cross-selling existing services. Clients frequently expand the scope of engagements during delivery to include follow-on complementary activities. Also, our on-site presence affords us the opportunity to become aware of, and to help define, additional project opportunities as they are identified by the client. The strong client relationships arising out of many engagements often facilitate our ability to market additional capabilities to clients in the future.

## Human Resources

As of December 31, 1998, we had approximately 1,500 employees. Our success depends in large part on attracting, retaining and motivating talented, creative and experienced professionals at all levels. In connection with our hiring efforts, we employ internal recruiters, retain executive search firms and utilize personal and



business contacts to recruit professionals with significant utility industry or consulting experience. Our consultants are drawn from utility and related industries, including engineering, construction and telecommunications, and from accounting and other consulting organizations. We promote loyalty and continuity of our consultants by offering packages of base and incentive compensation and benefits that we believe are significantly more attractive than those offered by the consulting industry in general.

We derive our revenues almost exclusively from services performed by our professional consultants. Our future performance will continue to depend in large part upon our ability to attract and retain highly-skilled professionals possessing appropriate skills and senior academics with superior professional reputations. Qualified professional consultants are in great demand and are likely to remain a limited resource for the foreseeable future. We may not be able to retain a substantial majority of our existing or future consultants for the long term. The loss of the services of, or the failure to recruit, a significant number of consultants could adversely affect our ability to secure and complete engagements and could have an adverse effect on our business.

In addition to the employees discussed above, we supplement our consultants on certain engagements with independent contractors, many of whom are former employees. We believe that the practice of retaining independent contractors on a per-engagement basis provides us with greater flexibility in adjusting professional personnel levels in response to changes in demand for our services.

## Competition

The market for consulting services is intensely competitive, highly fragmented and subject to rapid change. The market includes a large number of participants from a variety of market segments, including general management or marketing consulting firms, the consulting practices of national accounting firms, and local or regional firms specializing in utility services. Many information technology consulting firms also maintain significant practice groups devoted to the utility industry. Many of these companies are national and international in scope and have greater personnel, financial, technical and marketing resources than we do. We believe that our experience, reputation, industry focus and broad range of services will enable us to compete effectively in the consulting marketplace.

## Item 2--Facilities

Our headquarters are currently located in a 15,000 square foot building in Chicago, Illinois which we own. In addition to our headquarters, we lease office space in 41 cities. Additional space may be required as our business expands geographically, but we believe we will be able to obtain suitable space as needed.

We have principal offices in the following locations:

| Domestic | International |
|---|---|

| | | |
|---|---|---|
| Albany, NY | New York City, NY | Brussels, Belgium |
| Austin, TX | Oakbrook, IL | Buenos Aires, Argentina |
| Boston, MA | Orlando, FL | Copenhagen, Denmark |
| Cambridge, MA | Philadelphia, PA | London, England |
| Chicago, IL | Phoenix, AZ | Manila, Philippines |
| Clearwater, FL | Pittsburgh, PA | Melbourne, Australia |
| Colorado Springs, CO | Portland, OR | Sydney, Australia |
| College Station, TX | Princeton, NJ | Toronto, Canada |
| Dallas, TX | Richardson, TX | Toulouse, France |
| Emeryville, CA | Sacramento, CA | Wellington, New Zealand |
| Evanston, IL | Salt Lake City, UT | |
| Fairfield, CT | San Francisco, CA | |
| Houston, TX | Springfield, IL | |
| Los Angeles, CA | Tampa, FL | |
| Menlo Park, CA | Washington, DC | |
| | Westbury, NY | |



Item 3--Legal Proceedings

Peterson is a defendant in a lawsuit filed by National Council on Compensation Insurance ("NCCI") against Peterson, its former subsidiary Insurance Data Resources, Inc. ("IDR") and certain of their officers and former directors. The lawsuit alleges, among other things, that IDR violated certain copyrights and other intellectual property of NCCI and seeks to hold Peterson liable as IDR's sole shareholder. We no longer own IDR, but continue to have certain rights of indemnification against the former members of Peterson and the purchaser of IDR. The parties to the lawsuit agreed in principle to settle the dispute. The agreement would release all defendants, including Peterson, without any payments to NCCI, but is subject to the negotiation and execution of a definitive agreement. Although no assurances can be given, we do not believe this lawsuit will have a material adverse affect on our business. One of our directors, Governor James R. Thompson, is also a member of the board of directors of NCCI.

In addition, from time to time, we are party to various other lawsuits. We do not believe that any of our current lawsuits are material.

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

Not Applicable

Part II

Item 5--Market for the Registrant's Common Stock and Related Stockholder Matters

Our Common Stock is traded on the Nasdaq National Market under the symbol "METZ". The following table shows the range of reported high and low sales information for the Company's Common Stock, for the fiscal periods indicated, as reported on the Nasdaq National Market.

| | High | Low |
|---|---|---|
| Fiscal 1998: | | |
| January--March | $33.92 | $24.00 |
| April--June | $36.63 | $34.25 |
| July--September | $37.75 | $27.25 |
| October--December | $49.00 | $28.85 |

| Fiscal 1997: | | |
|---|---|---|
| January--March | $23.17 | $14.00 |
| April--June | $21.84 | $13.17 |
| July--September | $27.42 | $20.67 |
| October--December | $27.67 | $23.00 |

We had 215 holders of record of its Common Stock at March 12, 1999 and approximately 9,497 beneficial owners. We have never paid a cash dividend on its Common Stock and do not expect to pay a cash dividend on our Common Stock in the foreseeable future.



Item 6--Selected Financial Data

The selected financial data set forth below should be read in conjunction with our Financial Statements and related Notes thereto and with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

| | Years Ended December 31,(1) | | | |
|---|---|---|---|---|
| | 1998 | 1997 | 1996 | 1995 |
| Statement of Operations Data: | | | | |
| Revenues | $266,877 | $196,780 | $151,889 | $130,909 |
| Cost of services | 154,322 | 115,122 | 89,410 | 79,056 |
| Gross profit | 112,555 | 81,658 | 62,479 | 51,853 |
| General and administrative expenses(2) | 60,893 | 54,151 | 47,028 | 52,135 |
| Merger related costs | 12,778 | 1,312 | -- | -- |
| Operating income (loss) | 38,884 | 26,195 | 15,451 | (282) |
| Other expense (income), net(2) | (2,652) | (1,305) | 285 | (5,352) |
| Income before income tax expense | 41,536 | 27,500 | 15,166 | 5,070 |
| Income tax expense(3) | 25,413 | 9,081 | 9 | 476 |
| Net income | $ 16,123 | $ 18,419 | $ 15,157 | $ 4,594 |
| Pro forma net income (loss)(4) | $ 25,590 | $ 16,225 | $ 8,948 | ($367) |
| Pro forma net income (loss) per basic share | $ 0.71 | $ 0.51 | $ 0.29 | $ (0.01) |
| Pro forma net income (loss) per dilutive share | $ 0.69 | $ 0.50 | $ 0.29 | $ (0.01) |

| | As of December 31,(1) | | | |
|---|---|---|---|---|
| | 1998 | 1997 | 1996 | 1995 |
| Balance Sheet Data: | | | | |
| Cash and cash equivalents | $119,704 | $ 45,867 | $33,699 | $ 1,878 |
| Working capital | 146,509 | 58,269 | 45,984 | 11,451 |

| | | | | |
|---|---|---|---|---|
| Total assets................................. | 230,517 | 124,443 | 92,914 | 51,514 |
| Long-term debt, less current portion......... | -- | 319 | 1,490 | 1,027 |
| Total stockholders' equity................... | 164,904 | 68,672 | 50,387 | 12,569 |

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(1) The amounts above have been restated to reflect the transactions accounted for as poolings of interest as described in Note 3 of Notes to Consolidated Financial Statements.

(2) For the year ended December 31, 1995, general and administrative expenses include $4.3 million reported by Peterson for a restructuring charge related to the settlement of obligations under non cancelable operating leases and other moving and transition costs. Other income for the year ended December 31, 1995 includes an extraordinary gain of $5.7 million recorded by Peterson in connection with the extinguishment of certain other debt obligations.

(3) During the periods presented, certain of our operating subsidiaries were entities not subject to federal income taxation. The provision for income taxes for the year ended December 31, 1998 reflects a one-time, non-cash charge of $7.2 million resulting from the conversion of Peterson from the modified cash basis to the accrual basis for tax purposes.

(4) Pro forma net income: (1) for all periods presented prior to 1998 has been adjusted to reflect a provision for income taxes assuming a tax rate of 41% that would have been recorded had all subsidiaries been taxable C corporations during these periods; and (2) for the year ended December 31, 1998 has been increased by $2.3 million to reflect the impact of a new executive compensation plan adopted by Peterson and increased by $7.2 million to reflect the effect of a one-time, non-cash charge to income tax expense which resulted from Peterson's conversion from the modified cash basis to the accrual basis for tax purposes.



## Item 7--Management's Discussion and Analysis of Financial Condition and Results of Operations

Statements included in the Management's Discussion and Analysis of Financial Condition and Results of Operations which are not historical in nature, are intended to be, and are hereby identified as, "forward-looking statements" for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended by Public Law 104-6. When used in this section, the words "anticipate," "believe," "intend," "estimate," and "expect" and similar expressions as they relate to the Company or its management are intended to identify such forward-looking statements. The Company cautions readers that forward-looking statements, including without limitation, those relating to the Company's future business prospects, revenues, working capital, liquidity, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Company's reports with the SEC.

This Management's Discussion and Analysis of Financial Condition and Results of Operations relates to the Consolidated Financial Statements included in this annual report on Form 10-K.

### Overview

We are a leading nationwide provider of consulting services to energy based and other network and regulated industries. We offer a wide range of consulting services designed to assist our clients as they face changing regulation, increasing competition and evolving technology. The Company's services include: (1) management consulting; (2) information technology; and (3) litigation support.

We derive substantially all of our revenues from fees for professional services. Over the last three years, the substantial majority of our revenues have been generated under standard hourly or daily rates billed on a time-and-expenses basis. Our clients are typically invoiced on a monthly basis with revenue recognized as the services are provided.

Our most significant expenses are project personnel costs, which consist of consultant salaries and benefits, and travel-related direct project expenses. We typically employ our project personnel on a full-time basis, although we supplement our project personnel through the use of independent contractors. We retain contractors for specific client engagements on a task-specific, per diem basis during the period their expertise or skills are required. We believe that retaining contractors on a per-engagement basis provides us with greater flexibility in adjusting project personnel levels in response to changes in demand for our services.

Acquisitions

As part of our growth strategy, we expect to continue to pursue complementary acquisitions to expand our geographic reach, expand the breadth and depth of our service offerings and enhance our consultant base. In furtherance of this growth strategy, we have acquired fourteen consulting firms during 1997 and 1998. All of these transactions were accounted for as pooling of interests.

The following summarizes the significant pooling of interests acquisitions that we have made since our initial public offering through the end of 1998:

RMI. As of July 31, 1997, we acquired substantially all of the common stock of Resource Management International, Inc. in exchange for 3.2 million shares of our common stock (valued at approximately $75.3 million) and acquired the remaining minority interest in exchange for cash. RMI, based in Sacramento, California, is a leading provider of consulting services to gas, water, and electric utilities, with operations in the western and eastern United States and international marketplace. RMI's broad range of engineering, technical and economic regulatory services complemented our management consulting and information technology services.

Reed. As of August 15, 1997, we acquired substantially all of the common stock of Reed Consulting Group, Inc. in exchange for 0.8 million shares of our common stock (valued at approximately $17.6 million) and



acquired the remaining minority interest in exchange for cash. Reed, based in the Boston, Massachusetts area, provides strategic planning, operations management and economic and regulatory services to electric and natural gas utilities. Reed's operations expanded our services and client base in the northeast United States and internationally.

LECG. As of August 19, 1998, we acquired substantially all of the common stock of LECG, Inc. in exchange for 7.3 million shares of our common stock (valued at approximately $228.9 million) and acquired the remaining minority interest in exchange for cash. LECG, based in the San Francisco, California area, is a leading provider of economic consulting and litigation support services. LECG's operations further increased our economic and regulatory expertise and expanded our presence in the telecommunications industry.

Peterson. As of August 31, 1998, we acquired substantially all of the common stock of Peterson Worldwide, LLC in exchange for 5.6 million shares of our common stock (valued at approximately $156.7 million) and acquired the remaining minority interest in exchange for cash. Peterson, based in the Chicago, Illinois area, is a leading provider of information management services. Peterson's operations expanded our service offerings in the area of information technology.

We acquired LECG and Peterson in August 1998. These acquisitions are the largest we have made to date and we are in the process of integrating these companies, including their accounting and billing functions, into our operations. An inability to effectively integrate these or any companies acquired in the future may adversely affect our ability to bid successfully on engagements and to grow our business. Performance problems or dissatisfied clients at one company could have an adverse effect on our reputation as a whole. If our reputation were damaged, this could make it more difficult to market our services or to acquire additional companies in the future. In addition, acquired companies may not operate profitably. Acquisitions also involve a number of additional risks, including, among others, the following:

--Diversion of management's attention;
--Potential loss of key clients or personnel;
--Risks associated with unanticipated assumed liabilities and problems; and
--Risks of managing businesses or entering markets in which we have limited or no direct expertise.

We expect to continue to acquire companies as an element of our growth strategy. Acquisitions involve certain risks that could cause our actual growth to differ from our expectations. For example

--We may not be able to continue to identify suitable acquisition candidates or to acquire additional consulting firms on favorable terms.
--We compete with other companies to acquire consulting firms. We cannot predict whether this competition will increase. If competition does increase, there may be fewer suitable consulting firms available to be acquired and the price for suitable acquisitions may increase.
--We may not be able to integrate the operations (accounting and billing functions, for example) of businesses we acquire to realize the economic, operational and other benefits we anticipate.
--We may not be able to successfully integrate acquired businesses in a timely manner or we may incur substantial costs, delays or other operational or financial problems during the integration process.
--It may be difficult to integrate a business with personnel who have different business backgrounds and corporate cultures.



Results of Operations

The following table sets forth, for the periods indicated, selected statement of operations data as a percentage of revenues:

| | Years Ended December 31, | | |
| --- | --- | --- | --- |
| | 1998 | 1997 | 1996 |
| Revenues | 100.0% | 100.0% | 100.0% |
| Cost of services | 57.8 | 58.5 | 58.9 |
| Gross profit | 42.2 | 41.5 | 41.1 |
| General and administrative expenses | 22.8 | 27.5 | 31.0 |
| Merger-related costs | 4.8 | 0.7 | -- |
| Operating income | 14.6 | 13.3 | 10.1 |
| Other expense (income), net | (1.0) | (0.7) | 0.1 |
| Income before income tax expense | 15.6 | 14.0 | 10.0 |
| Income tax expense | 9.6 | 4.6 | 0.0 |
| Net income | 6.0% | 9.4% | 10.0% |

1998 Compared to 1997

Revenues. Revenues increased 35.6% to $266.9 million in 1998 from $196.8 million in 1997. This growth in revenues was due to several factors, including the expansion of services provided to existing clients, engagements with new clients, continued strong demand for management consulting services in energy based and other network and regulated industries as well as increased selling and business development efforts and immaterial acquisitions.

Gross Profit. Gross profit consists of revenues less cost of services, which includes consultant salaries, benefits and travel-related direct project expenses. Gross profit increased 37.8% to $112.6 million in 1998 from $81.7 million in 1997. Gross profit as a percentage of revenues was 42.2% in 1998 compared to 41.5% in 1997. The improvement in gross profit margin was the result of increased utilization of the Company's professional consultants coupled with higher average billing rates.

General and Administrative Expenses. General and administrative expenses include salaries and benefits of management and support personnel, facilities costs, training, direct selling, outside professional fees and all other corporate support costs. General and administrative expenses for the year ended December 31, 1998 were $60.9 million, or 23% of revenues compared to $54.2 million or 28% of revenues in the comparable 1997 period. The decrease of general and administrative costs as a percentage of revenues was primarily due to decreases in executive incentive compensation at companies acquired in 1998 coupled with increased efficiencies in certain support functions, improved economies of scale and the closing of certain duplicate facilities at the beginning of 1998.

Merger-Related Costs. During 1998, the Company incurred merger-related costs of $12.8 million related to the acquisitions of LECG and Peterson, which were accounted for as pooling of interests. These costs include legal, accounting and other transaction related fees and expenses, as well as accruals to consolidate certain facilities. In the prior year period, the Company incurred legal, accounting and other transaction related fees and expenses of $1.3 million related to the acquisitions of RMI and Reed, which were accounted for as pooling of interests.

Other Income, Net. Other income, net includes interest expense, interest income and other non-operating income and expenses. For the fiscal year ended December 31, 1998, other income, net was $2.7 million versus $1.3 million at 1997 year end. This increase is largely the result of higher interest income due to larger average cash balances outstanding during the period.

Income Tax Expense. The Company's effective income tax rate was 61.2% for the year ended December 31, 1998. The effective rate for this period would have been 39.4%, excluding the effect of the one-



time, non-cash charge to income tax expense of $7.2 million related to the conversion of Peterson from the modified cash basis to the accrual basis of accounting for tax purposes and the effect of certain merger-related expenses resulting from the acquisitions of LECG and Peterson that are not tax deductible. The Company's effective income tax rate was 33% for the year ended December 31, 1997. The effective rate would have been 38.2%, including federal and certain state income taxes that would have been required had all the Company's subsidiaries been taxable entities during this period.

1997 Compared to 1996

Revenues. Revenues increased 30% in 1997 to $196.8 million compared to $151.9 in 1996. The growth in revenues was primarily due to increased selling and business development efforts to generate new client engagements and increased demand for management consulting services in the Company's principal target industry segments.

Gross Profit. Gross profit increased 31% in 1997 to $81.7 million from $62.5 in 1996. Gross profit as a percentage of revenues increased to 42% in 1997 from 41% in 1996. The gross profit percentage was largely unchanged and average utilization rates for full-time personnel and a similar proportion of subcontracted labor were consistent in both periods.

General and Administrative Expenses. General and administrative expenses increased 15% to $54.2 million in 1997 from $47.0 million in 1996. As a percentage of revenues, general and administrative expenses decreased to 28% in 1997 from 31% in 1996. The decrease is attributable to economies of scale on certain fixed costs over the higher 1997 revenue base.

Other Income, Net. Other income, net for 1997 was $1.3 million, as opposed to other expense, net of $0.3 million in 1996. The increase is due in large part to a one-time gain in 1997 of $0.9 million related to the expiration of an option agreement entered into in 1993. The agreement called for the purchase of all of the assets or outstanding stock of LECG. The remainder of the increase is the result of higher interest income due to larger average cash balances during the period and a reduction in interest expense.

Income Tax Expense. The Company's effective income tax rate was 33% for 1997 and 0.1% for 1996. The effective tax rate would have been approximately 39% for both periods had all of the Company's subsidiaries been taxable entities during these periods.



Unaudited Quarterly Results

The following table sets forth certain unaudited quarterly operating information. These data have been prepared on the same basis as the audited financial statements contained elsewhere in this Form 10-K and include all normal recurring adjustments necessary for the fair presentation of the information for the periods presented, when read in conjunction with the Company's Consolidated Financial Statements and related Notes thereto. Results for any previous fiscal quarter are not necessarily indicative of results for the full year or for any future quarter.

| | Quarters Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Mar. 31, 1997 | June 30, 1997 | Sept. 30, 1997 | Dec. 31, 1997 | Mar. 31, 1998 | June 30, 1998 | Sept. 30, 1998 | Dec. 31, 1998 |
| | (In thousands) | | | | | | | |
| Revenues | $44,011 | $48,121 | $49,964 | $54,684 | $60,809 | $64,863 | $68,311 | $72,894 |
| Cost of services | 26,776 | 28,293 | 28,145 | 31,909 | 36,023 | 37,015 | 39,320 | 41,964 |
| Gross profit | 17,235 | 19,828 | 21,819 | 22,775 | 24,786 | 27,848 | 28,991 | 30,930 |
| General and administrative expenses | 12,043 | 13,145 | 13,991 | 14,971 | 15,887 | 17,747 | 13,304 | 13,955 |
| Merger-related costs | -- | -- | 1,312 | -- | -- | -- | 12,778 | -- |
| Operating income | 5,192 | 6,683 | 6,516 | 7,804 | 8,899 | 10,101 | 2,909 | 16,975 |
| Other income, net | (146) | (981) | (105) | (73) | (550) | (790) | (538) | (773) |
| Income before income tax expense | 5,338 | 7,664 | 6,621 | 7,877 | 9,449 | 10,891 | 3,447 | 17,748 |
| Income tax expense | 1,152 | 1,552 | 1,492 | 4,885 | 3,791 | 4,233 | 10,420 | 6,968 |
| Net income (loss) | $ 4,186 | $ 6,112 | $ 5,129 | $ 2,992 | $ 5,658 | $ 6,658 | $(6,973) | $10,780 |

Revenues and operating results fluctuate from quarter to quarter as a result of a number of factors, including the significance of client engagements commenced and completed during a quarter, the number of business days in a quarter and employee hiring and utilization rates. The timing of revenues varies from quarter to quarter due to factors such as the Company's sales cycle, the ability of clients to terminate engagements without penalty, the size and scope of assignments and general economic conditions. Because a significant percentage of the Company's expenses are relatively fixed, a variation in the number of client assignments or the timing of the initiation or the completion of client assignments can cause significant variations in operating results from quarter to quarter. Furthermore, the Company has on occasion experienced a seasonal pattern in its operating results, with a smaller proportion of the Company's revenues and lower operating income occurring in the fourth quarter of the year or a smaller sequential growth rate than in other quarters.

Liquidity and Capital Resources

Net cash provided by operating activities was $21.5 million for the year ended December 31, 1998. During the year, the primary sources of cash provided by operating activities were net income of $16.1 million and non-cash depreciation of $5.1 million. The higher volume of business in 1998 resulted in increases in both current assets and current liabilities for the year. While operating cash flow was negatively affected by the $25.5 million increase in accounts receivable and prepaid expenses and other assets, this was more than offset by the positive impact of the $22.7 million increase in current liabilities and the $3.0 million in other non-cash adjustments during the period.

The current year investing activities used net cash flows of $14.0 million, principally to support growth in personnel and services. These investments included leasehold improvements, furniture and equipment for new leased facilities, additional computer and related equipment for provision of information management consulting services by Peterson, and the purchase and related improvements of the Company's corporate headquarters in Chicago.



Financing activities provided net cash flows of $66.3 for the 1998 fiscal year. In March 1998 and again in November 1998, the Company sold 1.5 million shares of common stock in secondary offerings, raising approximately $35.6 million and $50.8 million, respectively, net of related offering costs. The Company received an additional $10.6 million from transactions related to stock option exercises, the employee stock purchase plan, and notes receivable from stockholders. Cash flows used by financing activities included $18.9 million for the purchase of certain minority interests of LECG and Peterson and included $8.1 million for the repayment of short-term debt and $6.1 million in payments of pre-acquisition, undistributed income to former stockholders of acquired companies.

As of December 31, 1998, the Company had approximately $119.7 million in cash and cash equivalents, resulting principally from cash flows from operations and the various public stock offerings during the previous three years. The Company believes that current cash and cash equivalents will provide adequate cash to fund its anticipated cash need over at least the next twelve months.

In general, the Company's internal information technology ("IT") and Non-IT systems are Year 2000 compliant. The Company does not expect to incur any additional costs for the purpose of Year 2000 compliance, nor does the Company believe that there is a significant risk of a material potential liability to third parties arising from Year 2000 issues.

Item 7A--Quantitative and Qualitative Disclosures About Market Risks

The Company's primary exposure to market risks relates to changes in interest rates associated with its investment portfolio included in cash equivalents on the consolidated balance sheet. The Company does not currently use derivative securities. The Company's general policy is to limit the risk of principal loss by limiting market and credit risks. The Company does not expect any material loss with respect to its investment portfolio.

The Company operates in foreign countries which exposes it to market risk associated with foreign currency exchange rate fluctuations; however, such risk is immaterial at this time to the Company's consolidated financial statements.

Item 8--Consolidated Financial Statements and Supplemental Data

The Consolidated Financial Statements of the Company are annexed to the report as pages F-1 through F-14. An index to such materials appears on page F-1.

Item 9--Changes in and Disagreements with Accountants on Accounting and Financial Discussions

Not Applicable.

Part III

The information required by this Part III will be provided in the definitive proxy statement for the Company's 1999 Annual Meeting of Stockholders (involving the election of directors), which definitive proxy statement (the "Proxy Statement") will be filed pursuant to Regulation 14A no later than 120 days following the Company's fiscal year ended December 31, 1998, and is incorporated herein by this reference to the extent provided below.

Item 10--Directors and Executive Officers of the Registrant

Information in response to this item is incorporated by reference herein from the section of the Proxy Statement captioned "Board of Directors--Director Compensation," "Management Compensation" and "Compliance with Section 16(a) of the Exchange Act."

Item 11--Executive Compensation

Information in response to this item is incorporated by reference herein from the section of the Proxy Statement captioned "Board of Directors--Director Compensation" and "Management Compensation."



Item 12--Security Ownership of Certain Beneficial Owners and Management

Information in response to this item is incorporated by reference herein from the section of the Proxy Statement captioned "Stock Ownership of Directors, Executive Officers and Principal Holders."

Item 13--Certain Relationships and Related Transactions

Information in response to this item is incorporated by reference herein from the section of the Proxy Statement captioned "Certain Relationships and Related Transactions."

Part IV

Item 14--Exhibits, Financial Statements and Reports on Form 8-K

The consolidated financial statements filed as part of this report are listed in the accompanying Index to Consolidated Financial Statements. The exhibits filed as part of this report are listed in the accompanying Exhibit Index.

On September 3, 1998, the Company filed with the Securities and Exchange Commission, an interim report on Form 8-K dated August 19, 1998 showing the condensed consolidated financial statements of LECG, Inc. as of December 31, 1997 and June 30, 1998 and the Company's Proforma Combined Balance Sheet as of March 31, 1998 and Proforma Combined Statements of Operations for the three years ended December 31, 1997.

On November 6, 1998 (and again on November 12, 1998 to correct an error by our financial printer), the Company filed with the Securities and Exchange

Commission, an interim report on Form 8-K/A showing the following:

A) Peterson financial statements as of December 31, 1997.

B) The Company's Proforma Combined Balance Sheet as of June 30, 1998 and Proforma Combined Statements of Operations for the three years ended December 31, 1997.

C) The Company's audited consolidated financial statements as of December 31, 1997 and 1996, and for the three years ended December 31, 1997, as restated.



SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

The Metzler Group, Inc.

/s/ Robert P. Maher
By: ________________________________
Robert P. Maher
Chairman, President and Chief Executive Officer, Director

/s/ Barry S. Cain
By: ________________________________
Barry S. Cain
Director

/s/ James F. Hillman
By: ________________________________
James F. Hillman
Chief Financial Officer

/s/ Peter B. Pond
By: ________________________________
Peter B. Pond
Director

/s/ Mitchell H. Saranow
By: ________________________________
Mitchell H. Saranow
Director

/s/ Govenor James R. Thompson
By: ________________________________
Govenor James R. Thompson
Director

Dated: March 31, 1999



INDEX TO THE FINANCIAL STATEMENTS
THE METZLER GROUP, INC.

Audited Consolidated Financial Statements as of December 31, 1998 and 1997, and for each of the three years in the period ended December 31, 1998





## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
The Metzler Group, Inc.:

We have audited the accompanying consolidated balance sheet of The Metzler Group, Inc. and subsidiaries as of December 31, 1998, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. 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 audit provides 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 The Metzler Group, Inc. and subsidiaries as of December 31, 1998, and the results of their operations and their cash flows for the year then ended in conformity with generally accepted accounting principles.

We previously audited and reported on the consolidated balance sheet of The Metzler Group, Inc. and subsidiaries as of December 31, 1997, and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 1997 and 1996, prior to their restatement for the 1998 pooling of interests, which report was based in part on reliance of other auditors. The contribution of the Company to combined restated assets represented 41 percent as of December 31, 1997; to combined restated revenues represented 43 percent and 42 percent; and to combined restated net income represented 53 percent and 38 percent for the years ended December 31, 1997 and 1996, respectively. Separate financial statements of the other companies included in the 1997 restated balance sheet and the 1997 and 1996 restated statements of operations, stockholders' equity and cash flows were audited and reported on separately by other auditors. We also audited the combination of the accompanying consolidated balance sheet as of December 31, 1997 and the statements of operations, stockholders' equity and cash flows for the years ended December 31, 1997 and 1996, after restatement for the 1998 pooling of interests; in our opinion, such consolidated statements have been properly combined on the basis described in Note 3 of the notes to the consolidated financial statements.

/s/ KPMG LLP

Chicago, Illinois

February 10, 1999



THE METZLER GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

| | DECEMBER 31, 1998 | DECEMBER 31, 1997 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $119,704 | $ 45,867 |
| Accounts receivable, net | 80,163 | 59,397 |
| Prepaid and other current assets | 6,979 | 3,337 |
| Total current assets | 206,846 | 108,601 |
| Property and equipment, net | 22,197 | 13,769 |
| Other assets | 1,474 | 2,073 |
| Total assets | $230,517 | $124,443 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term debt | -- | 8,070 |
| Accounts payable and accrued liabilities | 17,955 | 10,458 |
| Accrued compensation and project costs | 28,142 | 17,075 |
| Income taxes payable | 2,942 | 3,800 |
| Deferred income taxes | 2,171 | 1,500 |
| Stockholder distribution payable | -- | 5,357 |
| Other current liabilities | 9,127 | 4,072 |
| Total current liabilities | 60,337 | 50,332 |
| Long-term debt | -- | 319 |
| Deferred income taxes | 5,276 | 3,951 |
| Other non-current liabilities | -- | 1,169 |
| Total liabilities | 65,613 | 55,771 |
| Stockholders' equity: | | |
| Preferred stock, $.001 par value; 3,000 shares authorized; no shares issued or outstanding | -- | -- |
| Common stock, $.001 par value; 75,000 shares authorized; 38,004 and 34,043 shares issued and outstanding in 1998 and 1997, respectively | 38 | 34 |
| Additional paid-in capital | 134,624 | 56,580 |
| Notes receivable from stockholders | -- | (2,755) |
| Accumulated other comprehensive income | (30) | (57) |
| Retained earnings | 30,272 | 14,870 |
| Total stockholders' equity | 164,904 | 68,672 |
| Total liabilities and stockholders' equity | $230,517 | $124,443 |

See accompanying Notes to the Consolidated Financial Statements.

THE METZLER GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | FOR THE YEARS ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Revenues | $ 266,877 | $ 196,780 | $ 151,889 |
| Cost of services | 154,322 | 115,122 | 89,410 |
| Gross profit | 112,555 | 81,658 | 62,479 |
| General and administrative expenses | 60,893 | 54,151 | 47,028 |
| Merger-related costs | 12,778 | 1,312 | -- |
| Operating income | 38,884 | 26,195 | 15,451 |
| Other expense (income): | | | |
| Interest income | (3,061) | (1,156) | (420) |
| Interest expense | 672 | 432 | 840 |
| Other, net | (263) | (581) | (135) |
| Total other expense (income) | (2,652) | (1,305) | 285 |
| Income before income tax expense | 41,536 | 27,500 | 15,166 |
| Income tax expense | 25,413 | 9,081 | 9 |
| Net Income | $ 16,123 | $ 18,419 | $ 15,157 |
| Earnings per basic share: | | | |
| Net income | $ 0.45 | $ 0.58 | $ 0.49 |
| Shares used in computing earnings per basic share | 35,948 | 31,779 | 30,933 |
| Earnings per dilutive share: | | | |
| Net income | $ 0.43 | $ 0.57 | $ 0.48 |
| Shares used in computing earnings per dilutive share | 37,179 | 32,288 | 31,262 |
| Pro forma income data (unaudited): | | | |
| Net income | $ 16,123 | $ 18,419 | $ 15,157 |
| Pro forma decrease (increase) to income tax expense | 7,200 | (2,194) | (6,209) |
| Pro forma adjustment to executive compensation expense, net of tax | 2,267 | -- | -- |
| Pro forma net income | $ 25,590 | $ 16,225 | $ 8,948 |
| Pro forma net income per basic share | $ 0.71 | $ 0.51 | $ 0.29 |
| Pro forma net income per dilutive share | $ 0.69 | $ 0.50 | $ 0.29 |

See accompanying Notes to the Consolidated Financial Statements.



THE METZLER GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

| Preferred Stock | Common Stock | Additional | Notes Receivable | Accumulated Other | Total |
|---|---|---|---|---|---|

| | Shares | Amount | Shares | Amount | Paid-In Capital | From Stockholders | Comprehensive Income | Retained Earnings | Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 1995 | -- | -- | 30,760 | $ 31 | $ 7,713 | $(1,576) | $-- | $ 6,401 | $ 12,569 |
| Comprehensive income | -- | -- | -- | -- | -- | -- | 6 | 15,157 | 15,163 |
| Issuance of common stock | -- | -- | 4,553 | 5 | 41,905 | (1,619) | -- | -- | 40,291 |
| Purchase of common stock | -- | -- | (3,432) | (4) | (8,460) | -- | -- | (1,794) | (10,258) |
| Distributions | -- | -- | -- | -- | -- | (162) | -- | (7,683) | (7,845) |
| Interest on notes receivable from stockholders | -- | -- | -- | -- | 155 | (155) | -- | -- | -- |
| Collection of notes receivable from stockholders | -- | -- | -- | -- | -- | 467 | -- | -- | 467 |
| Balance at December 31, 1996 | -- | -- | 31,881 | 32 | 41,313 | (3,045) | 6 | 12,081 | 50,387 |
| Comprehensive income | -- | -- | -- | -- | -- | -- | (63) | 18,419 | 18,356 |
| Issuance of common stock | -- | -- | 2,697 | 2 | 25,412 | (87) | -- | 780 | 26,107 |
| Purchase of common stock | -- | -- | (535) | -- | (10,340) | 44 | -- | (228) | (10,524) |
| Distributions | -- | -- | -- | -- | -- | (351) | -- | (16,182) | (16,533) |
| Interest on notes receivable from stockholders | -- | -- | -- | -- | 195 | (195) | -- | -- | -- |
| Collection of notes receivable from stockholders | -- | -- | -- | -- | -- | 879 | -- | -- | 879 |
| Balance at December 31, 1997 | -- | -- | 34,043 | 34 | 56,580 | $(2,755) | (57) | 14,870 | 68,672 |
| Comprehensive income | -- | -- | -- | -- | -- | -- | 27 | 16,123 | 16,150 |
| Issuance of common stock | -- | -- | 4,556 | 5 | 96,957 | -- | -- | -- | 96,962 |
| Purchase of common stock | -- | -- | (595) | (1) | (18,921) | -- | -- | -- | (18,922) |
| Distributions | -- | -- | -- | -- | -- | -- | -- | (721) | (721) |
| Interest on notes receivable from stockholders | -- | -- | -- | -- | 8 | -- | -- | -- | 8 |
| Collection of notes receivable from stockholders | -- | -- | -- | -- | -- | 2,755 | -- | -- | 2,755 |
| Balance at December 31, 1998 | -- | $-- | 38,004 | $ 38 | $134,624 | $ -- | $(30) | $ 30,272 | $164,904 |

See accompanying Notes to the Consolidated Financial Statements.



THE METZLER GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | FOR THE YEARS ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Cash flows from operating activities: | | | |
| Net income | $ 16,123 | $ 18,419 | $ 15,157 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 5,098 | 3,578 | 2,833 |
| Provision for bad debts | 1,094 | 172 | 1,831 |
| Deferred income taxes | 1,996 | 2,363 | (952) |
| Other non-cash items, net | (107) | (728) | 80 |
| Changes in assets and liabilities, net of acquisitions: | | | |
| Accounts receivable | (21,861) | (12,138) | (8,940) |
| Prepaid expenses and other assets | (3,641) | (1,139) | (444) |
| Accounts payable and accrued liabilities | 7,497 | 2,644 | 3,419 |
| Accrued compensation and project costs | 11,066 | 97 | 6,164 |

| | | | |
|---|---|---|---|
| Income taxes payable | (857) | 2,922 | 549 |
| Other current liabilities | 5,056 | 1,340 | (4,861) |
| Net cash provided by operating activities | 21,464 | 17,530 | 14,836 |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (13,723) | (8,100) | (3,879) |
| Other, net | (238) | (656) | (499) |
| Net cash used in investing activities | (13,961) | (8,756) | (4,378) |
| Cash flows from financing activities: | | | |
| Issuance of common stock | 96,962 | 25,493 | 38,151 |
| Purchase of common stock | (18,922) | (10,175) | (9,806) |
| Repayment of long-term debt | (319) | (1,480) | (648) |
| Proceeds from long-term debt | -- | 3,300 | 1,799 |
| Net repayments of short-term debt | (8,070) | (2,793) | (389) |
| Payments of pre-acquisition undistributed income to former stockholders | (6,079) | (10,121) | (7,338) |
| Other, net | 2,762 | (830) | (406) |
| Net cash provided by financing activities | 66,334 | 3,394 | 21,363 |
| Net increase in cash and cash equivalents | 73,837 | 12,168 | 31,821 |
| Cash and cash equivalents at beginning of year | 45,867 | 33,699 | 1,878 |
| Cash and cash equivalents at end of year | $ 119,704 | $ 45,867 | $ 33,699 |
| Supplemental information: | | | |
| Interest payments | $ 672 | $ 305 | $ 544 |
| Income tax payments | $ 17,720 | $ 3,509 | $ 428 |

See accompanying Notes to Consolidated Financial Statements.



THE METZLER GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share amounts and unless as otherwise indicated)

## 1. DESCRIPTION OF BUSINESS

The Metzler Group, Inc. (the "Company") is a leading provider of consulting services to energy-based and related industries. The Company's services include: (1) management consulting; (2) information technology; and (3) litigation support. The Company's operating subsidiaries include LECG, Inc. ("LECG"), Metzler & Associates, Inc. ("Metzler & Associates"), Peterson Consulting, L.L.C. ("Peterson"), Reed Consulting Group, Inc. ("Reed"), and Resource Management International, Inc. ("RMI"). The Company is headquartered in Chicago, Illinois and has regional offices in various cities within the United States, and several international offices.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash equivalents are comprised of highly liquid instruments with original maturities of 90 days or less. The carrying amount of these financial instruments approximates fair value because of the short maturities.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method based on the estimated useful lives, ranging from three to forty years, of the various classes of property and equipment. Amortization of leasehold improvements is computed over the shorter of the lease term or the estimated useful life of the asset.

Revenue Recognition

The Company recognizes revenues as the related services are provided. Certain contracts are accounted for on the percentage of completion method whereby revenues are recognized based upon costs incurred in relation to total estimated costs at completion. Provision is made for the entire amount of estimated losses, if any, at the time when they are known.

Stock Based Compensation

The Company utilizes the intrinsic value-based method of accounting for its stock-based compensation arrangements.

Income Taxes

Income taxes, including pro forma calculations, are accounted for in accordance with the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to





differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Prior to January 1, 1996, Metzler & Associates had operated as a C-corporation. Effective January 1, 1996, the stockholders of Metzler & Associates elected to be taxed under Subchapter S of the Internal Revenue Code. During such period, federal income taxes were the responsibility of Metzler & Associates' stockholders as were certain state income taxes. As of the effective date of the election, Metzler & Associates was responsible for Federal built-in-gain taxes to the extent applicable. Accordingly, the consolidated statement of operations for the year ended December 31, 1996 provides for such taxes. The S-corporation election terminated in connection with the consummation of the initial public offering of the Company's common stock on October 4, 1996.

Prior to December 18, 1997, LECG had elected to be taxed under Subchapter S of the Internal Revenue Code for income tax purposes. During such period, federal income taxes were the responsibility of LECG's stockholders as were certain state income taxes. Therefore, the financial statements do not include a provision for federal (and some state) income taxes prior to LECG's initial public offering on December 18, 1997. LECG's S-corporation status terminated on December 18, 1997, thereby subjecting LECG's income to federal and certain other state income taxes at the corporate level. Accordingly, LECG applied the provisions of Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," for the period ended December 31, 1997. In addition, LECG converted from a cash basis to accrual basis for tax purposes in conjunction with its conversion to a C-corporation. Due to temporary differences in recognition of revenue and expenses, income for financial reporting purposes exceeded income for income tax purposes. The conversion to accrual basis along with these temporary differences resulted in the recognition of a net deferred tax liability (and a corresponding one-time charge to expense) of $2.7 million as of December 31, 1997.

Prior to August 14, 1998, Peterson was a limited liability company, which, for income tax purposes, was treated as a partnership. Accordingly, the income of Peterson was reported on the individual income tax returns of its members and federal income taxes, as well as certain state income taxes, were the responsibility of its members. Subsequent to August 14, 1998, and based on events unrelated to its acquisition by the Company, Peterson elected C-corporation status, thereby subjecting its income to federal and certain state income taxes at the corporate level. As a result of its acquisition of Peterson, the Company has applied the provisions of SFAS No. 109, and has converted Peterson from the modified cash basis to the accrual basis for tax purposes. Due to temporary differences in recognition of revenue and expense, income for financial reporting purposes has exceeded income for tax reporting purposes. The conversion to accrual basis, along with these temporary differences, resulted in the recognition of a one-time, non-cash charge of $7.2 million to be recorded during the period in which the merger occurred.

Pro Forma Adjustments (unaudited)

The pro forma adjustments for 1998 include a reduction of income tax expense to exclude the effect of the one-time, non-cash charge of $7.2 million which resulted from the conversion of Peterson from the modified cash basis to the accrual basis of accounting for tax purposes. The pro forma adjustments for 1998 also reflect a $2.3 million adjustment, net of tax, relating to the impact of a new compensation plan for Peterson executives adopted pursuant to the acquisition. This pro forma presentation, net of related tax effects, is shown solely as the result of changes in compensation that existed following consummation of the merger. These changes would have resulted in reduced compensation in prior periods for Peterson executives, although their duties and responsibilities would have remained largely unchanged.





The pro forma adjustments for 1997 and 1996 include federal and additional state income tax expense of $2,194 and $6,209, respectively, that would have been required if certain of the Company's subsidiaries which were not taxable entities during those periods had been subject to federal, and certain state, income taxes at the corporate level.

Earnings Per Share

For the years ended December 31, 1998, 1997 and 1996, earnings per share was computed in accordance with SFAS No. 128 "Earnings Per Share", which the Company adopted during the fourth quarter of 1997. The difference between basic and dilutive shares represents the dilutive effect of common stock options aggregating 1,231, 509 and 329 for the years ended December 31, 1998, 1997 and 1996, respectively.

Foreign Currency Translation

The balance sheets of the Company's foreign subsidiaries are translated into U.S. dollars using the year-end exchange rate, and sales and expenses are translated using the average exchange rate for the year. The resulting translation gains or losses are recorded as a separate component of stockholders' equity as other comprehensive income.

3. BUSINESS COMBINATIONS

On July 31, 1997, the Company issued 3.2 million shares of common stock for substantially all the outstanding common stock of RMI. Additionally, on August 15, 1997, the Company issued 0.8 million shares of common stock for substantially all of the outstanding common stock of Reed. Each of the transactions was accounted for as a pooling of interests. The consolidated financial statements have been restated as if RMI and Reed had been combined for all periods presented. The Company's consolidated statement of operations for the year ended December 31, 1997 includes revenues and net income from RMI and Reed totaling $28,906 and $1,529, respectively, through the dates of acquisition. The consolidated statement of operations for the year ended December 31, 1996 includes revenues and net loss from RMI and Reed totaling $41,460 and $1,119, respectively.

On August 19, 1998, the Company issued 7.3 million shares of common stock for substantially all the outstanding common stock of LECG. Additionally, on August 31, 1998, the Company issued 5.6 million shares of common stock for substantially all of the outstanding common stock of Peterson. Each of these transactions was accounted for as a pooling of interests and, accordingly, the consolidated financial statements have been restated as if the companies had been combined for all periods presented. The Company's consolidated statement of operations for the year ended December 31, 1998 includes revenues and net income from LECG and Peterson totaling $97,910 and $6,070, respectively, through the dates of acquisition. The Company's consolidated statements of operations for 1997 and 1996 have been restated to reflect revenues of $113,119 and $88,336, respectively, and net income of $8,732 and $9,422, respectively, for the aggregate of the operations of LECG and Peterson.

The Company incurred significant costs and expenses in connection with these acquisitions, including legal and accounting, and other various expenses. These costs and expenses were recorded in the consolidated statements of operations and comprehensive income during the third quarter in each of the years 1997 and 1998.

During 1998 and 1997, the Company completed nine additional transactions which were accounted for as poolings of interests. The stockholders' equity and the operations of these businesses were not material, individually or in the aggregate, in relation to those of the Company. As such, the Company recorded the





combinations by restating stockholders' equity as of the effective date of each acquisition without restating prior period financial statements.

4. STOCKHOLDERS' EQUITY

On October 4, 1996 the Company completed an initial public offering of its common stock in which 3.9 million shares were sold by the Company, resulting in proceeds of approximately $37 million, net of issuance costs. Concurrent with the completion of the initial public offering and in accordance with an agreement entered into during July 1996 between the Company and a stockholder, the Company redeemed 2.6 million shares of the stockholder's common stock for $7,975.

On December 18, 1997, LECG completed an initial public offering, resulting in net proceeds of approximately $24.4 million, net of issuance costs.

On March 2, 1998, the Company completed a secondary offering of its common stock in which an additional 1.5 million shares were sold by the Company, resulting in net proceeds of approximately $36 million. On November 19, 1998, the Company completed a secondary offering of its common stock in which an additional 1.5 million shares were sold by the Company, resulting in net proceeds of approximately $51 million.

5. ACCOUNTS RECEIVABLE

The components of accounts receivable as of December 31 were as follows:

| | 1998 | 1997 |
|---|---|---|
| Billed amounts | $81,508 | $51,595 |
| Engagements in process | 3,899 | 11,952 |
| Allowance for uncollectible accounts | (5,244) | (4,150) |
| | $80,163 | $59,397 |

Engagements in process represent balances accrued by the Company for services that have been performed but have not been billed to the customer. Billings are generally done on a monthly basis for the prior month's services.

6. PROPERTY AND EQUIPMENT

Property and equipment, at cost, as of December 31 consisted of:

| | 1998 | 1997 |
|---|---|---|
| Land and buildings | $ 2,878 | $ 370 |
| Furniture, fixtures and equipment | 27,877 | 27,418 |
| Software | 5,338 | 2,263 |
| Leasehold improvements | 4,736 | 3,072 |
| | 40,829 | 33,123 |
| Less: accumulated depreciation and amortization | (18,632) | (19,354) |
| | $22,197 | $13,769 |





7. SHORT-TERM AND LONG-TERM DEBT

The Company had total short-term debt and other current debt obligations of $0 and $8,070 at December 31, 1998 and 1997, respectively. Amounts outstanding at December 31 are as follows:

| | 1998 | 1997 |
|---|---|---|
| $1,200 in two lines of credit, interest payable quarterly at the bank's prime rate (8.5% at December 31, 1997) plus 1.0%, guaranteed by officers of a subsidiary, due April 1, 1998..... | -- | $1,020 |
| Two lines of credit, $4,100 each, interest payable quarterly at the bank's prime rate (8.5% at December 31, 1997), collateralized by accounts receivable of Peterson, outstanding balance due on demand........................................ | -- | 3,300 |
| $3,645 term loan, payable in monthly installments of $100 including interest at the bank's prime rate (8.5% at December 31, 1997), collateralized by accounts receivable of Peterson, and subject to renewal annually.............................. | -- | 3,645 |
| Other term loans, at variable rates of interest of 9.25% through 15.0% with due dates 1998 through 2001................ | -- | 424 |
| Total debt.................................................. | -- | 8,389 |
| Portion classified as long-term............................. | -- | 319 |
| Short-term debt............................................. | $-- | $8,070 |

The Company maintains line of credit agreements in the aggregate amount of $14.0 million expiring through July 1999. Of this total, $6,175 is available to secure commercial and standby letters of credit. At December 31, 1998, the Company had letters of credit of $1,657 outstanding. The letters of credit expire at various dates through 1999.

8. LEASE COMMITMENTS

The Company leases its office facilities and certain equipment under operating lease arrangements which expire at various dates through 2008 with renewal options of two to five years. The Company leases office facilities under noncancelable operating leases which include fixed or minimum payments plus, in some cases, scheduled base rent increases over the term of the lease and additional rents based on the Consumer Price Index. Certain leases provide for monthly payments of real estate taxes, insurance and other operating expenses applicable to the property. The total amount of the base rent payments is being charged to expense as incurred. In addition, the Company leases equipment under noncancelable operating leases.

Future minimum annual lease payments, for the years subsequent to 1998 and in the aggregate, are as follows:

| Year Ending December 31, | Amount |
|---|---|
| 1999..................................................... | $ 9,781 |
| 2000..................................................... | 8,623 |
| 2001..................................................... | 8,146 |
| 2002..................................................... | 5,195 |
| 2003..................................................... | 3,149 |
| Thereafter............................................... | 5,449 |
| | $40,343 |

Rent expense for operating leases entered into by the Company and charged to operations amounted to $9,982 for 1998, $9,791 for 1997, and $7,150 for 1996.





## 9. INCOME TAX EXPENSE

Income tax expense consists of the following:

| | December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Federal: | | | |
| Current | $19,980 | $5,108 | $477 |
| Deferred | 1,600 | 2,648 | (574) |
| Total | 21,580 | 7,756 | (97) |
| State: | | | |
| Current | 3,437 | 1,392 | 409 |
| Deferred | 396 | (67) | (303) |
| Total | 3,833 | 1,325 | 106 |
| Total federal and state income tax expense | $25,413 | $9,081 | $ 9 |

Income tax expense differs from the amounts estimated by applying the statutory income tax rates to income before income tax expense as follows:

| | December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Federal tax at statutory rate | 35.0% | 35.0% | 35.0% |
| State tax at statutory rate, net of federal tax benefits | 4.9 | 4.6 | 4.6 |
| Effect of nontaxable interest and dividends | (1.9) | (0.9) | (0.6) |
| Effect of nontaxable entities | -- | (5.2) | (39.0) |
| Effect of conversion from cash to accrual method of accounting for acquired company | 17.3 | -- | -- |
| Effect of non-deductible merger-related costs | 4.5 | -- | -- |
| Other | 1.4 | (0.5) | 0.1 |
| | 61.2% | 33.0% | 0.1% |

Deferred income taxes result from temporary differences between years in the recognition of certain expense items for income tax and financial reporting purposes. The source and income tax effect of these differences are as follows:

| | December 31, 1998 | December 31, 1997 |
|---|---|---|
| Deferred tax assets: | | |
| State income taxes | $ 479 | $ 155 |
| Allowance for uncollectible receivables | 194 | 340 |
| Merger-related costs | 1,427 | 382 |
| Other | 315 | 236 |
| Total deferred tax assets | 2,415 | 1,113 |
| Deferred tax liabilities: | | |
| Adjustment resulting from changes in the method of accounting used for tax purposes | 9,136 | 6,080 |
| Other | 726 | 484 |
| Deferred tax liabilities | 9,862 | 6,564 |
| Net deferred tax liabilities | $7,447 | $5,451 |





## 10. LONG-TERM INCENTIVE PLAN

On June 30, 1996, the Company adopted a Long-Term Incentive Plan which provides for common stock, common stock-based, and other performance incentives to employees, consultants, directors, advisors, and independent contractors of the Company. As of December 31, 1998, the Company had 5,510 options outstanding at a weighted average exercise price of $24.19 per share which was equal to the fair market value of common stock at the dates of grant. As of December 31, 1998, 138 options were exercisable. In general, the options have a ten year term and are exercisable in annual installments over a four year period following the date of grant.

The Company applies APB Opinion 25, Accounting for Stock Issued to Employees, and related Interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized. Had compensation cost for the plan been determined based on the fair value at the grant dates for awards under the plan consistent with the method of SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's compensation expense for the years ended December 31, 1998, 1997 and 1996 would have been increased by $4,591, $1,138 and $102, respectively, net of related income taxes. As a result, the Company's pro forma net earnings available to common stockholders and earnings per common and common equivalent shares would have been reduced to the pro forma amounts indicated below:

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Earnings per common share, as reported: | | | |
| Net income | $16,123 | $18,419 | $15,157 |
| Net income per basic share | $ 0.45 | $ 0.58 | $ 0.49 |
| Net income per dilutive share | $ 0.43 | $ 0.57 | $ 0.48 |

| | | | |
|---|---|---|---|
| Earnings per common share, fair value method: | | | |
| Net income, with compensation expense from fair value options | $11,532 | $17,281 | $15,055 |
| Fair value method net income per basic share | $ 0.32 | $ 0.54 | $ 0.49 |
| Fair value method net income per dilutive share | $ 0.31 | $ 0.54 | $ 0.48 |

The weighted average fair value of options granted in 1998, 1997 and 1996 was $5.68, $4.46 and $2.00 respectively. For purposes of calculating compensation cost under SFAS No. 123, the fair value of each option grant is estimated as of the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in the model for grants made in 1998, 1997 and 1996:

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Expected volatility | 45% | 45% | 40% |
| Risk free interest rate | 5.0% | 5.7% | 6.5% |
| Dividend yield | 0% | 0% | 0% |
| Expected lives | 2.8 years | 2.5 years | 3.0 years |

Additional information on the shares subject to options is as follows:

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Number of Shares | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price |
| Options outstanding at beginning of year | 2,623 | $16.53 | 689 | $10.37 | -- | $ -- |
| Granted | 3,849 | 28.47 | 2,173 | 18.35 | 725 | 10.00 |
| Exercised | (361) | 13.07 | (3) | 8.00 | -- | -- |
| Forfeited | (601) | 24.90 | (236) | 16.35 | (36) | 8.00 |
| Options outstanding at end of year | 5,510 | $24.19 | 2,623 | $16.53 | 689 | $10.37 |
| Options exercisable at year end | 138 | $14.41 | 14 | $18.45 | -- | $ -- |





The following table summarizes information about stock options outstanding at December 31, 1998 and 1997:

| 1998 | 1997 |
|---|---|

| Range of Exercise Price | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Life | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Life |
|---|---|---|---|---|---|---|
| $0 to $15 | 1,025 | $12.46 | 0.7 years | 1,534 | $12.60 | 1.5 years |
| $16 to $25 | 1,277 | 20.99 | 2.5 years | 1,089 | 22.14 | 2.2 years |
| $26 to $35 | 3,174 | 29.06 | 3.6 years | -- | -- | -- |
| $36 to $45 | 34 | 39.30 | 3.8 years | -- | -- | -- |
| | 5,510 | $24.19 | 2.8 years | 2,623 | $16.53 | 1.8 years |

## 11. EMPLOYEE BENEFIT PLANS

The Company maintained profit sharing and savings plans for six of our operating subsidiaries through December 31, 1998. Eligible employees may contribute a portion of their compensation to their respective operating subsidiaries' plan. The Company, at its discretion matches a percentage of employees' contributions. The Company may also make an annual profit sharing contribution at its discretion. The Company, as sponsor of the plans, uses independent third parties to provide administrative services to the plans. The Company has the right to terminate the plans at any time. The Company contributions to the various plans which were charged to operations were $1,018, $976 and $1,356 in the years ended December 31, 1998, 1997, and 1996, respectively.

## 12. SEGMENT INFORMATION

The Company has applied the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. This statement establishes standards for reporting information regarding operating segments, products and services, geographic areas and major customers. The Company's operations represent a single reportable segment under the provisions of SFAS No. 131. The Company's operations have a high degree of similarity in their economic and operational characteristics, including the nature of the services provided, the type or class of customers for those services, and the methods used for delivering such services. While the Company has retained certain brand identities associated with its principal operating subsidiaries, these distinctions have not been a critical factor for management in making operating decisions or in assessing performance. In addition, the structure of the Company's internal organization has changed from time to time as a result of acquisition activity and in response to customer, project, personnel or geographic requirements and, as such, discrete financial information is not available on a consistent basis at the operating subsidiary level.

## 13. SUBSEQUENT EVENT (unaudited)

Effective February 7, 1999 (the "Effective Date"), the Company completed the acquisition of all of the outstanding securities of Strategic Decisions Group ("SDG"), a consulting firm organized under the laws of California. Pursuant to a Merger Agreement dated February 7, 1999, a wholly owned subsidiary of the Company, MGI Acquisition III, Inc., merged with and into SDG on the Effective Date. Consequently, SDG is now a wholly owned subsidiary of the Company. SDG stockholders received Company common stock valued at approximately $125 million, calculated by using the final closing bid for the Company's common stock on the Effective Date, in exchange for substantially all outstanding SDG shares. The Company exchanged 2.7 million shares of its common stock for substantially all of the outstanding common stock of SDG. The transaction will be accounted for by the pooling of interests method of accounting and will qualify as a tax-free reorganization. Following the combination with SDG, the Company had 40.5 million issued and outstanding shares.

# EXHIBIT INDEX

| Exhibit No. | Description |
| --- | --- |
| 3.1 | Amended and Restated Certificate of Incorporation of the Company (2) |
| 3.2 | Amendment No. 1 to Amended and Restated Certificate of Incorporation of the Company (4) |
| 3.2 | Amended and Restated By-Laws of the Company (5) |
| 4.1 | Specimen Common Stock Certificate (3) |
| 4.2 | Form of Registration Agreement |
| 10.1 | Form of Indemnification Agreement between the Company and each of its directors and officers (3) |
| 10.2 | The Metzler Group, Inc. Long-Term Incentive Plan (1) |
| 10.3 | Amendment No. 1 to The Metzler Group, Inc. Long Term Incentive Plan, dated November 1, 1997 (6) |
| 10.4 | Amendment No. 2 to the Metzler Group, Inc. Long-Term Incentive Plan, effective May 1, 1998 (6) |
| 10.5 | The Metzler Group, Inc. Employee Stock Purchase Plan (7) |
| 10.6 | Amendment No. 1 to The Metzler Group, Inc. Employee Stock Purchase Plan |
| 10.7 | Amendment No. 2 to The Metzler Group, Inc. Employee Stock Purchase Plan |
| 21.1 | Significant Subsidiaries of The Metzler Group, Inc. |
| 23.1 | Consent of KPMG LLP |
| 27.1 | Financial Data Schedule--for the period ended December 31, 1998 |

- --------

(1) Incorporated by reference from the Registrant's Registration Statement on Form S-8 (Registration No. 333-30267 filed with the SEC on June 27, 1997.

(2) Incorporated by reference from the Registrant's Amendment No. 1 to Registration Statement on Form S-1 (Registration No. 333-9019) filed with the SEC on September 4, 1996.

(3) Incorporated by reference from the Registrant's Amendment No. 2 to Registration Statement on Form S-1 (Registration No. 333-9019) filed with the SEC on September 20, 1996.

(4) Incorporated by reference from the Registrant's Registration Statement on Form S-3 (Registration No. 333-40489) filed with the SEC on November 18, 1997.

(5) Incorporated by reference from the Registrant's Amendment No. 1 to Registration Statement on Form S-3 (Registration No. 333-40489) filed with the SEC on February 12, 1998.

(6) Incorporated by reference from the Registrant's Post-Effective Amendment No. 1 to Registration Statement on Form S-8 (Registration No. 333-30267) filed with the SEC on March 31, 1999.

(7) Incorporated by reference from the Registrant's Registration Statement on Form S-8 (Registration No. 333-30265) filed with the SEC on June 27, 1997.

Exhibit 4.2

FORM OF REGISTRATION AGREEMENT

THIS REGISTRATION AGREEMENT (this "Agreement") is made effective as of ________ ___, 1999, between The Metzler Group, Inc., a Delaware corporation (the "Company"), and each of the holders who execute and deliver a signature page hereto (individually a "Holder" and collectively, the "Holders").

RECITAL

The parties to this Agreement are parties to that certain Stock Exchange Agreement dated as of ______ ___, 1998 (the "Stock Exchange Agreement") by and among the Company, _______________, an __________ corporation ("XXX"), and the Holders, pursuant to which the Company is acquiring from the Holders all of the capital stock of XXX and in connection therewith the Company is issuing shares of Common Stock (as defined below) to the Holders. In order to induce the Holders to enter into the Stock Exchange Agreement, the Company has agreed to provide the registration rights set forth in this Agreement. Unless otherwise provided in this Agreement, capitalized terms used herein shall have the meanings set forth in Section 7 hereof.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing Recital and the mutual covenants and agreements herein contained and intending to be legally bound hereby, the parties hereby agree as follows:

1. Piggyback Registrations.

(a) Right to Piggyback. If, at any time during which any Registrable Securities remain outstanding (other than during a Lock-Up Period (as defined in the Stock Exchange Agreement)), the Company proposes to register any of its Common Stock under the Securities Act in an underwritten public offering, other than pursuant to a registration on Form S-8 or Form S-4 or any similar forms then in effect, (a "Piggyback Registration"), the Company will give prompt written notice to all Holders of its intention to effect such a registration (the "Registration Notice") and will, subject to the terms of this Agreement, include in such registration all Registrable Securities of the Holders with respect to which the Company has received written requests for inclusion therein within 15 days after the receipt of the Company's notice, not to exceed a maximum number of shares for each such Holder equal to 20% of such Holder's Registrable Securities.

(b) Priority on Primary Registrations. If a Piggyback Registration includes primary shares to be sold on behalf of the Company, and the managing underwriter or underwriters advise the Company that in their opinion the number of securities requested to be included in such registration exceeds the number which can be sold in such offering without materially adversely affecting the marketability of the offering, the Company will include in such registration, (i) first, the securities the Company proposes to sell and (ii) second, the Registrable Securities requested to be included in such registration and all other Common Stock requested to be included in such registration (the "Other Common Stock"), to be included pro rata on the basis of the number of shares of such securities for which the Company has been given written requests for inclusion therein by each such holder thereof.

(c) Priority on Secondary Registrations. If a Piggyback Registration is an underwritten secondary registration on behalf of holders of the Company's securities (not including primary shares), and the managing underwriter or underwriters advise the Company that in their opinion the number of securities requested to be included in such registration exceeds the number which can be sold in such offering without adversely affecting the marketability of the offering, the Company will include in such registration (i) first, the securities requested to be included therein by the Priority Holders, and (ii) second, the Registrable Securities requested to be included in such registration by the Holders and all Other Common Stock requested to be included in such registration, to be included pro rata on the basis of the number of shares of such securities for which the Company has been given written requests for inclusion therein by each such holder thereof.

(d) Holdback Agreements. Each holder of Registrable Securities agrees not to effect any public sale or distribution (including sales pursuant to Rule 144) of equity securities of the Company, or any securities convertible into or exchangeable or exercisable for such securities, during the seven days prior to and the 90-day period beginning on the effective date of any Piggyback Registration, whether or not such Holder's Registrable Securities are included therein (except as part of such underwritten registration), unless the Company and the underwriters managing the registered public offering otherwise agree.

2. Certain Procedures. In connection with any Piggyback Registration, the Company will, as expeditiously as possible but subject to the terms hereof:

(a) furnish each seller of Registrable Securities such number of copies of such Registration Statement, each amendment and supplement thereto, the prospectus included in such Registration Statement (including each preliminary prospectus) and such other documents as such seller may reasonably request in order to facilitate the disposition of the Registrable Securities owned by such seller;

(b) use all commercially reasonable efforts to register or qualify such Registrable Securities under the securities or blue sky laws of such states and the District of Columbia as any seller of Registrable Securities reasonably requests and do any and all other acts and things which may be reasonably necessary or advisable to enable such seller to consummate the disposition in such states and the District of Columbia of the Registrable Securities owned by Holder (provided that the Company will not be required to (i) qualify generally to do business in any jurisdiction where it would not otherwise be required to qualify but for this subsection (b), (ii) subject itself to taxation in any such jurisdiction or (iii) consent to general service of process in any such jurisdiction);

(c) notify each seller of such Registrable Securities of the happening of any event (other than a possible acquisition) of which the Company becomes aware, as a result of which the prospectus included in such Registration Statement contains an untrue statement of a material fact or omits any fact necessary to make the statements therein not misleading,



(d) cause all such Registrable Securities to be listed on each securities exchange on which similar securities issued by the Company are then listed and, if not so listed, to be listed on the Nasdaq National Market; and

(e) otherwise use all commercially reasonable efforts to comply with all applicable rules and regulations of the Commission, and make available to its security holders, as soon as reasonably practicable, an earnings statement covering the period of at least twelve months beginning with the first day of the Company's first full calendar quarter after the effective date of the Registration Statement, which earnings statement shall satisfy the provisions of Section 11(a) of the Securities Act and Rule 158 thereunder.

3. Holder Procedures.

(a) In connection with any Registration Statement, the Company may require each Holder to furnish to the Company such information regarding such Holder and his or her proposed distribution of Registrable Securities, to the extent necessary to comply with the Securities Act, as the Company may from time to time reasonably request in writing.

(b) Each Holder agrees to cooperate with the Company in all reasonable respects in connection with the preparation and filing of each Registration Statement and any amendment thereof, any prospectus relating thereto and any prospectus supplement relating thereto with respect to the offer and sale of Registrable Securities of such Holder.

4. Registration Expenses. All expenses incident to the Company's performance of or compliance with this Agreement, including all NASD registration and filing fees, fees and expenses of compliance with securities or blue sky laws, listing fees, printing expenses, messenger and delivery expenses, and fees and disbursements of counsel for the Company and all independent certified public accountants, and other Persons retained by the Company (all such expenses being herein called "Registration Expenses"), will be borne by the Company; provided, that Registration Expenses shall not include, and the Holders of Registrable Securities shall pay, any underwriting discounts or brokers fees and commissions applicable to Registrable Securities sold by them pursuant to this Agreement and all legal fees and expenses of counsel retained by the Holders.

5. Indemnification and Contribution.

(a) The Company shall indemnify and hold harmless, to the fullest extent permitted by law, each Holder against all losses, claims, damages, liabilities and expenses (including reasonable fees and legal expenses) resulting from any untrue or alleged untrue statement of a material fact contained in the Registration Statement, any prospectus, or any amendment or supplement thereto, or any omission or alleged omission of a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, except in each case insofar as the same arises out of or is based upon an untrue statement or alleged untrue statement of a material fact or an omission or alleged omission to state a material fact in such Registration Statement, prospectus, amendment or supplement, as the case may be, made or omitted, as the case may be, in reliance upon and in conformity with information furnished to the Company by such Holder for use therein or by such Holder's failure to deliver a copy of the Registration Statement or



prospectus or any amendments or supplements thereto after the Company has furnished Holder with a sufficient number of copies of the same.

(b) The Holders participating in any Registration Statement shall indemnify and hold harmless, to the fullest extent permitted by law, the Company, its officers, directors, employees, representatives and agents, and each Person who controls (within the meaning of the Securities Act) the Company, against all losses, claims, damages, liabilities and expenses (including reasonable costs of investigation and legal expenses) resulting from any untrue or alleged untrue statement of a material fact contained in any Registration Statement, any prospectus, or any amendment or supplement thereto, and any omission or alleged omission of a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, to the extent the same arises out of or is based upon any untrue statement or alleged untrue statement of a material fact or any omission or alleged omission to state a material fact in such Registration Statement, prospectus, amendment or supplement, as the case may be, made or omitted, as the case may be, in reliance upon and in conformity with information furnished to the Company by such Holder for use therein.

(c) Each party entitled to indemnification under this Section 5 (the "Indemnified Party") shall give notice to the party required to provide indemnification (the "Indemnifying Party") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom; provided, that counsel for the Indemnifying Party, who will conduct the defense of such claim or litigation, is approved by the Indemnified Party (whose approval will not be unreasonably withheld or delayed); and provided, further, that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations except to the extent that its defense of the claim or litigation involved is prejudiced by such failure. The Indemnified Party may participate in such defense at such Indemnified Party's expense. No Indemnifying Party, in the defense of any such claim or litigation, except with the prior consent of each Indemnified Party, shall consent to entry of any judgment or enter into any settlement that does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect of any claim or litigation, and no Indemnified Party will consent to entry of any judgment or settle any claim or litigation without the prior written consent of the Indemnifying Party. Each Indemnified Party shall furnish such information regarding himself, herself or itself and the claim in question as the Indemnifying Party may reasonably request and as shall be reasonably required in connection with the defense of such claim and litigation resulting therefrom.

(d) If for any reason the indemnification provided for in this Section 5 from an Indemnifying Party, although otherwise applicable by its terms, is determined by a court of competent jurisdiction to be unavailable to an Indemnified Party hereunder, then the Indemnifying Party, in lieu of indemnifying such Indemnified Party, shall contribute to the amount paid or payable by the Indemnified Parties as a result of such losses, claims, damages, liabilities or expenses in such proportion as is appropriate to reflect the relative fault of such Indemnifying Party and the Indemnified Parties in connection with the actions that resulted in such losses, claims, damages, liabilities or expenses, as well as any other relevant equitable



considerations. The relative fault of such Indemnifying Party and the Indemnified Parties shall be determined by reference to, among other things, whether any action in question, including any untrue or alleged untrue statement of a material fact, has been made by, or relates to information supplied by, such Indemnifying Party or the Indemnified Parties, and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such action. The amount paid or payable by a party as a result of the losses, claims, damages, liabilities and expenses referred to above shall be deemed to include, subject to the limitations set forth in Section 5(c), any legal or other fees or expenses reasonably incurred by such party in connection with any investigation or proceeding.

6. Participation in Underwritten Registrations. No Person may participate in any registration hereunder which is underwritten unless such Person (a) agrees to sell such Person's securities on the basis provided in any underwriting arrangements approved by the Company and other Person or Persons entitled hereunder to approve such arrangements and (b) completes and executes all questionnaires, powers of attorney, share custody agreements, indemnities, underwriting agreements and other documents required under the terms of such underwriting arrangements.

7. Definitions.

"Business Day" means each Monday, Tuesday, Wednesday, Thursday and Friday that is not a day on which banking institutions in the City of Chicago are authorized or obligated by law or executive order to close.

"Common Stock" means the Company's Common Stock, par value $0.001 per share.

"Commission" means the Securities and Exchange Commission.

"Person" means any natural person and any corporation, partnership, limited liability company or other business entity.

"Registration Statement" means a registration statement filed with the Commission under the Securities Act in connection with a Piggyback Registration.

"Registrable Securities" means, with respect to each Holder, (i) the Metzler Common (as defined in the Stock Exchange Agreement) issued to such Holder pursuant to the Stock Exchange Agreement, and (ii) any Common Stock or other equity securities issued or issuable with respect to the securities referred to in clause (i) by way of a stock dividend or stock split or in connection with a combination of shares, recapitalization, merger, consolidation or other reorganization. As to any particular Registrable Securities, such securities will cease to be Registrable Securities (A) when they have been distributed to the public pursuant to a offering registered under the Securities Act or (B) after the Registrable Securities held by such Holder first become eligible for sale pursuant to Rule 144 under the Securities Act (or any similar rule then in force), subject to any restrictions in the amount and manner of sale and notice requirements contained therein.

"Securities Act" means the Securities Act of 1933, as amended.



8. Miscellaneous.

(a) Amendments and Waivers. Except as otherwise provided herein, the provisions of this Agreement may be amended or waived only upon the prior written consent of the Company and holders of at least a majority of the Registrable Securities.

(b) Successors and Assigns. All covenants and agreements in this Agreement by or on behalf of any of the parties hereto will bind and inure to the benefit of the respective successors and permitted assigns; provided, however, that rights to cause the Company to register Registrable Securities pursuant to this Agreement may be assigned by a Holder to a transferee or assignee of such securities only if (i) such assignment is made with all related obligations, (ii) the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; (iii) such transferee or assignee agrees in writing to be bound by and subject to the terms and conditions of this Agreement; and (iv) immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Securities Act.

(c) Construction. The parties have jointly participated in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the parties and no presumptions or burdens of proof shall arise favoring any party by virtue of the authorship of any of the provisions of this Agreement. The term "include" and its derivatives shall have the same construction as the phrase "include, without limitation," and its derivatives. The section headings contained in this Agreement are inserted for convenience or reference only and shall not affect in any way the meaning or interpretation of this Agreement.

(d) Severability. It is the intent and desire of the parties that the provisions of this Agreement be enforced to the fullest extent permissible under the laws and public policies as applied in each jurisdiction in which enforcement of the provisions of this Agreement are sought. If any particular provision of this Agreement shall be adjudicated by a court of competent jurisdiction to be invalid or unenforceable, such provision shall be amended, without any action on the part of any party hereto, to delete therefrom the portion so adjudicated to be invalid or unenforceable, such deletion to apply only with respect to the operation of such provision in the particular jurisdiction in which such adjudication is made. If any provision of this Agreement is adjudicated by a court of competent jurisdiction to be invalid or unenforceable in its entirety, this Agreement shall be amended to delete such provision therefrom and the remainder of this Agreement shall remain in full force and effect in such jurisdiction and without such deletion in all other jurisdictions.

(e) Counterparts. This Agreement may be executed simultaneously in two or more counterparts, any one of which need not contain the signatures of more than one party, but all such counterparts taken together will constitute one and the same agreement.

(f) Governing Law. The corporate law of Delaware will govern all issues concerning the relative rights of the Company and its stockholders. All other questions concerning



the construction, validity and interpretation of this Agreement and the exhibits and schedules hereto will be governed by the internal law, and not the law of conflicts, of Illinois.

(i) Notices. All notices, requests, demands, claims, and other communications hereunder will be in writing. Any notice, request, demand, claim, or other communication hereunder shall be deemed duly given (i) three (3) business days after it is sent by registered or certified mail, return receipt requested, postage prepaid; (ii) one day after receipt is electronically confirmed, if sent by fax (provided that a hard copy shall be promptly sent by first class mail); or (iii) one (1) business day following deposit with a recognized national overnight courier service for next day delivery charges prepaid, and, in each case, addressed to the intended recipient as set forth below:

| If to Metzler: | With a copy to: |
|---|---|
| The Metzler Group, Inc.<br>615 N. Wabash<br>Chicago, Illinois 60611<br>Attn: General Counsel<br>Fax: 312/573-5676 | Sachnoff & Weaver, Ltd.<br>Suite 2900<br>Chicago, Illinois 60606<br>Attn: J. Todd Arkebauer<br>Fax: 312/207-6400 |
| **If to the Holders:** | **With a copy to:** |
| To their respective addresses set forth on the signature page hereto | --------------------------<br>--------------------------<br>--------------------------<br>Attn:____________________<br>Fax: ____________________ |

Any party may give any notice, request, demand, claim, or other communication hereunder using any other means (including personal delivery, expedited courier, messenger service, telecopy, telex, ordinary mail, or electronic mail), but no such notice, request, demand, claim, or other communication shall be deemed to have been duly given unless and until it actually is delivered to the individual for whom it is intended. Any party may change the address to which notices, requests, demands, claims, and other communications hereunder are to be delivered by giving the other Parties notice in the manner herein set forth.

(g) Aggregation of Stock. All shares of Registrable Securities held or acquired by affiliated Persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

(h) Termination. The Company's obligations hereunder shall terminate upon the earlier of (i) with respect to a particular Holder, such Holder having sold 20% of the Registrable Securities and (ii) after the Registrable Securities held by such Holder first become eligible for sale pursuant to Rule 144 under the Securities Act (or any similar rule then in force), subject to any restrictions in the amount and manner of sale and notice requirements contained therein.



IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

THE COMPANY:

THE METZLER GROUP, INC.

By: --------------------------

Name: --------------------------

Title: --------------------------

HOLDERS:

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Address: --------------------------
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Fax: ____________________

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Address: --------------------------
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Fax: ____________________

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Address: --------------------------
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Fax: ____________________

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# FIRST AMENDMENT TO METZLER GROUP, INC. EMPLOYEE STOCK PURCHASE PLAN

The Metzler Group, Inc. Employee Stock Purchase Plan (the "Plan") is hereby amended, effective October 1, 1997, as follows:

1. Section 8 shall be amended to add the following sentence to the second paragraph thereof:

"If, within two (2) years of an Offering Date or within one (1) year of the Purchase Date associated with such Offering Date, the Participant requests delivery to him of the shares of Common Stock held in his Account and purchased during such Offering Period, or otherwise notifies the Committee to sell such associated shares of Common Stock held in his Account, the Participant shall be required to cease participation in the Plan effective as of the date of such request or notification. The Participant may recommence participation in the Plan thereafter in accordance with Section 9 of the Plan."

2. Section 9 of the Plan shall be amended to add the following sentence:

"After ceasing participation in the Plan, as required under Section 8 hereof, a Participant may reenter the Plan no earlier than the Offering Date that is coincident with or next follows the six (6) month anniversary of the date such cessation became effective."

# SECOND AMENDMENT TO THE METZLER GROUP, INC. EMPLOYEE STOCK PURCHASE PLAN

The Metzler Group, Inc. Employee Stock Purchase Plan (the "Plan") is hereby amended, effective October 1, 1997, as follows:

1. Section 2(i) of the Plan shall be amended in its entirety to change the definition of "Employee" to read as follows:

> "Employee means any person who is employed by the Company or an Affiliate on a regular full-time basis. A person shall be considered employed on a regular full-time basis if he is customarily employed for more than twenty (20) hours per week."

2. Section 3 of the Plan shall be amended in its entirety to change the paragraph entitled "Eligibility" to read as follows:

> "All employees shall be eligible to participate in the Plan on the Effective Date. Subject to the enrollment limitations of Section 6, each Employee of the Company shall be eligible to participate on the first to occur of (i) the Offering Date coincident with or next following the Employee's first day of employment, or (ii) the first day of any calendar month coincident with or next following the Employee's first day of employment."

Exhibit 21.1

SIGNIFICANT SUBSIDIARIES OF THE METZLER GROUP, INC.

| Name | State of Incorporation | Doing Business As |
|---|---|---|
| LECG, Inc. | California | |
| Metzler & Associates, Inc. | Illinois | |
| Peterson Consulting, L.L.C. | Illinois | Peterson Worldwide LLC |
| Reed Consulting Group, Inc. | Delaware | |
| Resource Management International, Inc. | California | |
| Strategic Decisions Group | California | |

Consent of KPMG LLP

The Board of Directors
The Metzler Group, Inc.

We consent to incorporation by reference in the registration statement No. 333-30267) on Form S-8 of The Metzler Group, Inc. of our report dated February 10, 1999, relating to the consolidated balance sheets of The Metzler Group, Inc. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1998, which report appears in the December 31, 1998, annual report on Form 10-K of The Metzler Group, Inc.

KPMG LLP

Chicago, Illinois
March 29, 1999

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