

LABOR READY INC
Form 10-Q
November 01, 2007

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

FORM 10-Q

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

For the quarterly period ended: September 28, 2007

or

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

Commission File Number: 001-14543

LABOR READY, INC.

(Exact name of Registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-1287341
(IRS Employer
Identification No.)

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1015 A Street, Tacoma, Washington
(Address of principal executive offices)

98402
(Zip Code)

Registrant's telephone number, including area code: **(253) 383-9101**

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of October 26, 2007, there were 43,952,577 shares of the registrant's common stock outstanding.

Documents incorporated by reference: None.

LABOR READY, INC.

INDEX

Part I. Financial Information

| | | |
|----------------|--|----|
| <u>Item 1.</u> | <u>Financial Statements</u> | |
| | <u>Consolidated Balance Sheets</u> | |
| | <u>September 28, 2007 and December 29, 2006</u> | 3 |
| | <u>Consolidated Statements of Income</u> | |
| | <u>Thirteen and Thirty-Nine Weeks Ended September 28, 2007 and September 29, 2006</u> | 5 |
| | <u>Consolidated Statements of Cash Flows</u> | |
| | <u>Thirty-Nine Weeks Ended September 28, 2007 and September 29, 2006</u> | 6 |
| | <u>Notes to Consolidated Financial Statements</u> | 7 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 22 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 22 |

Part II. Other Information

| | | |
|-------------------|--|----|
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 23 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | 23 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 23 |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> | 23 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 24 |
| <u>Item 5.</u> | <u>Other Information</u> | 24 |
| <u>Item 6.</u> | <u>Exhibits</u> | 24 |
| <u>Signatures</u> | | 25 |

PART I. Financial Information

Item 1. Financial Statements

LABOR READY, INC.

CONSOLIDATED BALANCE SHEETS

In Thousands

ASSETS

| | September 28, 2007 (Unaudited) | December 29, 2006 |
|--|--------------------------------------|----------------------|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 55,884 | \$ 107,944 |
| Marketable securities | 10,697 | 91,510 |
| Accounts receivable | 160,607 | 125,282 |
| Allowance for doubtful accounts | (7,098) | (5,109) |
| Prepaid expenses, deposits and other | 17,353 | 15,651 |
| Income tax receivable | - | 2,229 |
| Deferred income taxes | 12,268 | 2,251 |
| Total current assets | 249,711 | 339,758 |
| PROPERTY AND EQUIPMENT: | | |
| Buildings and land | 23,444 | 21,505 |
| Computers and software | 52,068 | 39,341 |
| Cash dispensing machines | 14,401 | 14,280 |
| Furniture and equipment | 10,211 | 8,345 |
| | 100,124 | 83,471 |
| Less accumulated depreciation and amortization | 57,465 | 51,522 |
| Property and equipment, net | 42,659 | 31,949 |
| OTHER ASSETS: | | |
| Restricted cash and other assets | 142,922 | 143,731 |
| Deferred income taxes | 1,302 | 6,972 |
| Goodwill | 53,231 | 37,364 |
| Other assets, net | 36,681 | 32,532 |
| Total other assets | 234,136 | 220,599 |
| Total assets | \$ 526,506 | \$ 592,306 |

See accompanying notes to consolidated financial statements

LABOR READY, INC.

CONSOLIDATED BALANCE SHEETS

In Thousands (Except Par Values)

LIABILITIES AND SHAREHOLDERS' EQUITY

| | September 28, 2007 (Unaudited) | December 29, 2006 |
|---|--------------------------------------|----------------------|
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 26,095 | \$ 22,653 |
| Accrued wages and benefits | 25,950 | 25,596 |
| Current portion of workers' compensation claims reserve | 51,909 | 52,229 |
| Income tax payable | 5,992 | - |
| Other current liabilities | 255 | 907 |
| Total current liabilities | 110,201 | 101,385 |
| LONG-TERM LIABILITIES: | | |
| Workers' compensation claims reserve, less current portion | 144,826 | 137,206 |
| Other non-current liabilities | 1,654 | 1,197 |
| Total long-term liabilities | 146,480 | 138,403 |
| Total liabilities | 256,681 | 239,788 |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred stock, \$0.131 par value, 20,000 shares authorized; No shares issued and outstanding | -- | -- |
| Common stock, no par value, 100,000 shares authorized; 43,941 and 50,637 shares issued and outstanding | 1 | 76,372 |
| Cumulative foreign currency translation adjustment, net of tax | 4,264 | 2,717 |
| Cumulative unrealized gain on marketable securities | 3 | 11 |
| Retained earnings | 265,557 | 273,418 |
| Total shareholders' equity | 269,825 | 352,518 |
| Total liabilities and shareholders' equity | \$ 526,506 | \$ 592,306 |

See accompanying notes to consolidated financial statements

LABOR READY, INC.

CONSOLIDATED STATEMENTS OF INCOME

In Thousands (Except Per Share Data)

(Unaudited)

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|--|-----------------------|-----------------------|-------------------------|-----------------------|
| | September 28, 2007 | September 29, 2006 | September 28, 2007 | September 29, 2006 |
| Revenue from services | \$ 390,672 | \$ 374,126 | \$ 1,032,040 | \$ 1,010,970 |
| Cost of services | 265,168 | 253,262 | 701,858 | 687,738 |
| Gross profit | 125,504 | 120,864 | 330,182 | 323,232 |
| Selling, general and administrative expenses | 89,077 | 81,790 | 248,355 | 235,523 |
| Depreciation and amortization | 3,402 | 2,441 | 8,661 | 7,909 |
| Income from operations | 33,025 | 36,633 | 73,166 | 79,800 |
| Interest expense | (116) | (149) | (803) | (582) |
| Interest and other income | 2,620 | 3,167 | 9,026 | 9,347 |
| Interest and other income, net | 2,504 | 3,018 | 8,223 | 8,765 |
| Income before tax expense | 35,529 | 39,651 | 81,389 | 88,565 |
| Income tax | 12,806 | 14,823 | 29,545 | 33,655 |
| Net income | \$ 22,723 | \$ 24,828 | \$ 51,844 | \$ 54,910 |
| Net income per common share: | | | | |
| Basic | \$ 0.51 | \$ 0.48 | \$ 1.12 | \$ 1.04 |
| Diluted | \$ 0.51 | \$ 0.48 | \$ 1.11 | \$ 1.03 |
| Weighted average shares outstanding: | | | | |
| Basic | 44,487 | 51,690 | 46,484 | 52,882 |
| Diluted | 44,784 | 52,009 | 46,775 | 53,361 |

See accompanying notes to consolidated financial statements

LABOR READY, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

In Thousands

(Unaudited)

| | Thirty-Nine Weeks Ended | |
|---|-------------------------|-----------------------|
| | September 28, 2007 | September 29, 2006 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 51,844 | \$ 54,910 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,661 | 7,909 |
| Provision for doubtful accounts | 7,543 | 5,445 |
| Deferred income taxes | (4,458) | (8,993) |
| Stock-based compensation | 5,457 | 5,129 |
| Excess tax benefits from stock-based compensation | (1,293) | (3,741) |
| Other operating activities | 105 | 423 |
| Changes in operating assets and liabilities, exclusive of business acquired: | | |
| Accounts receivable | (34,904) | (27,366) |
| Income taxes | 10,829 | 5,798 |
| Other assets | 298 | (6,559) |
| Accounts payable | 1,696 | (3,708) |
| Accrued wages and benefits | (342) | 529 |
| Workers' compensation claims reserve | 5,621 | 17,568 |
| Other current liabilities | - | (38) |
| Net cash provided by operating activities | 51,057 | 47,306 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (16,311) | (10,141) |
| Purchases of marketable securities | (146,901) | (59,410) |
| Maturities of marketable securities | 227,706 | 57,771 |
| Purchase of Skilled Services Corporation, net of cash acquired | (26,456) | - |
| Change in restricted cash and other assets | 809 | 284 |
| Other | (167) | (167) |
| Net cash provided by (used in) investing activities | 38,680 | (11,663) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Purchase and retirement of common stock | (148,233) | (59,865) |
| Net proceeds from sale of stock through options and employee benefit plans | 4,092 | 3,385 |
| Excess tax benefits from stock-based compensation | 1,293 | 3,741 |
| Payments on debt | (842) | (1,013) |
| Net cash used in financing activities | (143,690) | (53,752) |
| Effect of exchange rates on cash | 1,893 | 985 |
| Net change in cash and cash equivalents | (52,060) | (17,124) |
| CASH AND CASH EQUIVALENTS, beginning of period | 107,944 | 82,155 |
| CASH AND CASH EQUIVALENTS, end of period | \$ 55,884 | \$ 65,031 |

Notes to Consolidated Financial Statements

NOTE 1: ACCOUNTING PRINCIPLES AND PRACTICES

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The accompanying unaudited consolidated financial statements are prepared in accordance with generally accepted accounting principles for interim financial information and rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures usually found in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments, which in the opinion of management are necessary to fairly state the financial position, results of operations and cash flows for the interim periods presented. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the year ended December 29, 2006. Operating results for the thirty-nine week period ended September 28, 2007 are not necessarily indicative of the results that may be expected for the year ending December 28, 2007.

The consolidated financial statements are presented on a 52/53-week fiscal year end basis, with the last day of the fiscal year ending on the last Friday of December. Fiscal years 2007 and 2006 are 52-week years.

Revenue recognition

Revenue from services is recognized at the time the service is performed and is net of adjustments related to customer credits. A portion of our revenue is derived from cash dispensing machine (CDM) fees, which are immaterial for all periods presented. Sales coupons or other incentives are recognized in the period the related revenue is earned.

Cost of services

Cost of services includes the wages of temporary employees, related payroll taxes and benefits, workers' compensation expenses and transportation.

Share repurchases

Share repurchases are not displayed separately as treasury stock on the Consolidated Balance Sheets in accordance with the Washington Business Corporation Act, which requires the retirement of repurchased shares. As a result, shares of our common stock that we repurchase are retired immediately. It is our accounting policy to first record these repurchases as a reduction to our Common stock account. Once the Common stock account has been reduced to a nominal balance, remaining repurchases are recorded as a reduction to our Retained earnings account. See Note 10 for further discussion of share repurchases.

Shares outstanding

Shares outstanding for reportable purposes include shares of unvested restricted stock. As of September 28, 2007, 0.6 million shares of unvested restricted stock were included in reportable shares outstanding. Shares of unvested restricted stock are excluded from our calculation of basic net income per common share, but their dilutive impact is added back in the calculation of diluted net income per common share.

New accounting pronouncements

We adopted the provisions of Financial Standards Accounting Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) an interpretation of FASB Statement No. 109 (SFAS 109) on December 30, 2006, the first day of our 2007 fiscal year. See Note 11 for further discussion.

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which establishes a framework for measuring fair value and requires expanded disclosure about the information used to measure fair value. The statement applies whenever other statements require, or permit, assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances and is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2007, with early adoption encouraged. We do not anticipate the adoption of SFAS No. 157 will have a material effect on our consolidated financial position, results of operations or cash flows.

In February, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which modifies certain presentation and disclosure requirements in the Consolidated Balance Sheets and applies

to all entities with available-for-sale and trading securities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We do not anticipate the adoption of SFAS No. 159 will have a material effect on our consolidated financial position, results of operations or cash flows.

NOTE 2: BUSINESS COMBINATIONS

On April 30, 2007, pursuant to a Stock Purchase Agreement, we acquired all of the stock of Skilled Services Corporation (SSC), a privately-held Florida corporation, for \$26.5 million, net of cash acquired. Founded in 1993, SSC is a skilled construction trades staffing provider. At the date of purchase, SSC operated 17 locations in Florida, Texas, Arizona, California, Colorado, and North Carolina. Goodwill recognized as a result of the SSC acquisition totaled \$15.8 million, of which \$13.7 million is deductible for tax purposes.

NOTE 3: RESTRICTED CASH AND OTHER ASSETS

We have cash deposits and other restricted assets with independent financial institutions predominantly for the purpose of securing our workers compensation obligations.

We have agreements with certain financial institutions through our wholly-owned and consolidated subsidiary, Workers Assurance of Hawaii, Inc. (our Workers Assurance Program), that allow us to restrict cash for the purpose of providing cash-backed instruments for our workers compensation collateral. These instruments include cash-backed letters of credit, cash held in trusts as well as cash deposits held by our insurance carriers. Committed collateral represents instruments that have been provided or pledged to an insurance company to cover the cost of claims in the event we are unable to make payment.

We have agreements with certain financial institutions through our wholly-owned and consolidated subsidiary, Work

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The following is a summary of restricted cash and other assets (in millions):

| | September 28, 2007 | December 29, 2006 |
|--|-------------------------------|------------------------------|
| Workers Assurance Program committed collateral | \$132.8 | \$138.7 |
| Cash collateralizing surety bonds | 4.0 | 3.8 |
| Workers Assurance Program uncommitted cash | 4.5 | 0.5 |
| Other | 1.6 | 0.7 |
| Total Restricted Cash and Other Assets | \$142.9 | \$143.7 |

NOTE 4: RECEIVABLES FROM INSURANCE COMPANIES

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For workers compensation claims originating in self-insured states, the majority of our current workers compensation insurance policies from independent, third-party carriers, cover any claims for a particular event above a \$2.0 million deductible, on a per occurrence basis.

Our workers compensation reserves include not only estimated expenses for claims within our deductible layer but also estimated expenses related to claims above our deductible limits (excess claims). We record an estimated receivable for the insurance coverage on excess claims based on the contractual policy agreements we have with insurance companies. We discount this receivable to its estimated net present value using the risk-free rates associated with the weighted average lives of our excess claims. The weighted average claim lives are actuarially determined. When appropriate, based on our best estimate, we record a valuation allowance against the insurance receivable to reflect amounts that may not be realized.

Two of the workers compensation insurance companies (Troubled Insurance Companies) with which we formerly did business are in liquidation and have failed to pay a number of excess claims to date. These excess claims have been presented to the state guaranty funds of the states in which the claims originated. Certain of these excess claims have been rejected by the state guaranty funds due to statutory eligibility limitations. We have concluded that recovery is unlikely on a portion of these claims. Therefore, we have recorded a valuation allowance against the insurance receivables from the Troubled Insurance Companies not covered by state guaranty funds.

Our valuation allowance against receivables from Troubled Insurance Companies as of September 28, 2007 and December 29, 2006 is \$5.4 million and \$2.5 million, respectively. Total discounted receivables from insurance companies, net of related valuation allowance, as of September 28, 2007 and December 29, 2006 are \$15.0 million and \$16.6 million, respectively and are included in Other assets, net in the accompanying Consolidated Balance Sheets.

We also record a receivable for other matters where we expect reimbursement from our insurance company. Included in Prepaid expenses, deposits and other in the accompanying Consolidated Balance Sheets at September 28, 2007 is a receivable from our insurance company of \$1.2 million in connection with certain litigation.

NOTE 5: INTANGIBLE ASSETS

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The following table presents our purchased intangible assets other than Goodwill, which are included in Other assets, net in the Consolidated Balance Sheets (in thousands):

| | September 28, 2007 | December 29, 2006 |
|--|-----------------------|----------------------|
| Amortizable intangible assets: | | |
| Trade name/trademarks | \$ 600 | \$ 400 |
| Customer relationships | 18,600 | 11,600 |
| Non-compete agreements | 2,100 | 1,600 |
| | 21,300 | 13,600 |
| Less accumulated amortization | 7,785 | 5,726 |
| Total amortized intangible assets, net | \$ 13,515 | \$ 7,874 |
| Unamortizable intangible assets: | | |
| Trade name/trademarks | \$ 6,500 | \$ 6,500 |
| Total unamortizable intangible assets | \$ 6,500 | \$ 6,500 |

Intangible assets other than Goodwill recorded as a result of the SSC acquisition in April 2007 totaled \$7.7 million. Intangible assets other than Goodwill are amortized using the straight line method over their estimated useful lives. Amortization expense of our amortizable intangible assets was \$0.9 million for the thirteen weeks ended September 28, 2007 and \$0.6 million for the thirteen weeks ended September 29, 2006. Amortization expense of our amortizable intangible assets was \$2.1 million for the thirty-nine weeks ended September 28, 2007 and \$2.1 million for the thirty-nine weeks ended September 29, 2006.

The following table provides estimated amortization expense of intangible assets other than Goodwill for the next five years and thereafter (in thousands):

| | | |
|-------------------|----|--------|
| Remainder of 2007 | \$ | 868 |
| 2008 | | 3,175 |
| 2009 | | 3,075 |
| 2010 | | 3,025 |
| 2011 | | 2,892 |
| Thereafter | | 480 |
| | \$ | 13,515 |

Goodwill totaled \$53.2 million at September 28, 2007 and \$37.4 million at December 29, 2006. Goodwill at September 28, 2007 included \$15.8 million recorded as a result of the SSC acquisition in April 2007; \$31.0 million recorded as a result of the CLP Resources acquisition in 2005 and \$6.4 million recorded as a result of the Spartan Staffing acquisition in 2004.

NOTE 6: WORKERS COMPENSATION INSURANCE AND RESERVES

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We provide workers' compensation insurance to our temporary and permanent employees. Our workers' compensation insurance policies must be renewed annually. Our current coverage with American International Group, Inc. (AIG) is for occurrences during the period from July 2007 through July 2008. While we have primary responsibility for all claims, our insurance coverage provides reimbursement for certain losses and expenses beyond the deductible limits. For workers' compensation claims originating in self-insured states, the majority of our current workers' compensation insurance policies cover any claims for a particular event above a \$2.0 million deductible, on a per occurrence basis. This results in our being substantially self-insured. Furthermore, we have full liability for all further payments on claims which originated between January 2001 and June 2003,

without recourse to any third party insurer as the result of a novation agreement we entered into with Kemper Insurance Company in December 2004.

Our workers' compensation reserve is discounted to its estimated net present value using discount rates based on average returns of risk-free Treasury instruments, which are evaluated on a quarterly basis. At September 28, 2007, our reserves are discounted at rates ranging from 4.39% to 6.01%. Included in the accompanying Consolidated Balance Sheets as of September 28, 2007 and December 29, 2006 are discounted workers' compensation claims reserves in the amounts of \$196.7 million and \$189.4 million, respectively.

For workers' compensation claims originating in Washington, West Virginia, North Dakota, Wyoming, Canada and Puerto Rico (our monopolistic jurisdictions) we pay workers' compensation insurance premiums and obtain full coverage under government-administered programs. Accordingly, because we are not the primary obligor, our financial statements do not reflect the liability for workers' compensation claims in these monopolistic jurisdictions.

Workers' compensation expense is recorded as part of our cost of services and consists of the following components: self-insurance reserves net of changes in discount, monopolistic jurisdictions premiums, insurance premiums, any changes in the valuation allowance related to receivables from Troubled Insurance Companies as described in Note 4 and other miscellaneous expenses. Workers' compensation expense totaling \$18.3 million and \$21.3 million was recorded for the thirteen weeks ended September 28, 2007 and September 29, 2006, respectively. Workers' compensation expense totaling \$50.7 million and \$58.9 million was recorded for the thirty-nine weeks ended September 28, 2007 and September 29, 2006, respectively.

NOTE 7: NET INCOME PER SHARE

Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is calculated by dividing adjusted net income by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares include the dilutive effects of outstanding options and non-vested restricted stock except where their inclusion would be anti-dilutive.

Anti-dilutive shares associated with our stock options relate to those stock options with a grant price higher than the average market value of our stock during the periods presented. Commencing with fiscal year 2006, post SFAS No. 123R adoption, anti-dilutive shares also include in-the-money options for which the sum of the assumed proceeds, including unrecognized compensation expense, exceeds the average stock price during the quarter. The weighted average number of anti-dilutive stock options and non-vested restricted stock not considered as part of our calculation were 0.5 million during the thirteen weeks ended September 28, 2007 and 0.6 million during the thirteen weeks ended September 29, 2006. The weighted average number of anti-dilutive stock options and non-vested restricted stock not considered as part of our calculation were 0.6 million during the thirty-nine weeks ended September 28, 2007 and 0.4 million during the thirty-nine weeks ended September 29, 2006.

The following tables present the calculation of Net income per common share- Basic and Diluted (in thousands, except per share data):

| Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|-----------------------------|----------------------|--------------------------------|----------------------|
| September 28, | September 29, | September 28, | September 29, |

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| | 2007 | 2006 | 2007 | 2006 |
|--|-----------|-----------|-----------|-----------|
| Net income | \$ 22,723 | \$ 24,828 | \$ 51,844 | \$ 54,910 |
| Weighted average number of common shares used in basic net income per common share | 44,487 | 51,690 | 46,484 | 52,882 |
| Dilutive effect of outstanding stock options and non-vested restricted stock | 297 | 319 | 291 | 479 |
| Weighted average number of common shares used in diluted net income per common share | 44,784 | 52,009 | 46,775 | 53,361 |
| Net income per common share: | | | | |
| Basic | \$ 0.51 | \$ 0.48 | \$ 1.12 | \$ 1.04 |
| Diluted | \$ 0.51 | \$ 0.48 | \$ 1.11 | \$ 1.03 |

The decrease in weighted average shares year over year is primarily due to our share repurchase program. See Note 10 for further discussion.

NOTE 8: COMMITMENTS AND CONTINGENCIES

Revolving Credit Facility

We have an \$80.0 million credit agreement with certain unaffiliated financial institutions (the Revolving Credit Facility) that expires in November 2008. The Revolving Credit Facility, which is secured by substantially all our assets except our real estate, provides us with access to loan advances and letters of credit. The amounts we may borrow (our borrowing capacity) under this agreement are largely a function of the levels of our accounts receivable from time to time, supplemented by pledged collateral. Under the terms of the Revolving Credit Facility, we pay a variable rate of interest based on a margin above LIBOR for borrowings and a variable unused commitment fee, both based on a consolidated leverage ratio of consolidated total debt to consolidated EBITDA. Fees for letters of credit are based on the margin in effect plus a fee of 0.05%. As of September 28, 2007, our margin was 0.50% and our unused capacity fee was 0.15%. At September 28, 2007, we had \$33.9 million of letters of credit issued against that borrowing capacity leaving us with \$46.1 million available for future borrowings. The Revolving Credit Facility requires that we comply with certain financial covenants. Among other things, these covenants require us to maintain certain leverage and coverage ratios. We are currently in compliance with all covenants related to the Revolving Credit Facility.

Workers Compensation Commitments

We are required by our insurance carriers and certain state workers compensation programs to collateralize a portion of our workers compensation obligation with cash and cash-backed instruments, irrevocable letters of credit, or surety bonds. The letters of credit issued against the Revolving Credit Facility bear fluctuating annual fees, which were approximately 0.55% of the principal amount of the letters of credit outstanding as of September 28, 2007. The letters of credit issued related to our Workers Assurance Program bear fluctuating annual fees, which were approximately 0.58% of the principal amount of the letters of credit outstanding as of September 28, 2007. The surety bonds bear annual fees based on a percentage of the bond, which are determined by each independent surety carrier but do not exceed 2.0% of the bond amount, subject to a minimum charge.

At September 28, 2007 and December 29, 2006 we had provided our insurance carriers and certain states with commitments in the form and amounts outlined below (in millions):

Workers Compensation Commitments as of:

| | September 28, 2007 | December 29, 2006 |
|--|-------------------------------|------------------------------|
| Workers Assurance Program - committed collateral | \$ 132.8 | \$ 138.7 |
| Letters of credit | 33.9 | 45.5 |
| Surety bonds (1) | 16.9 | 17.6 |
| Other cash backed instruments | 1.1 | 0.6 |
| Total Collateral Commitments | \$ 184.7 | \$ 202.4 |

(1) We had \$4.0 million and \$3.8 million of restricted cash collateralizing our surety bonds at September 28, 2007 and December 29, 2006, respectively.

Legal Contingencies and Developments

From time to time we are the subject of compliance audits by federal, state and local authorities relating to a variety of regulations including wage and hour laws, taxes, workers compensation, immigration and safety. From time to time we are also subject to legal proceedings in the ordinary course of our operations. A summary of our most significant pending litigation and regulatory proceedings is set forth below. It is not possible at this time for us to determine fully the effect of all legal proceedings on our consolidated financial position, results of operations or liquidity; however, to the extent possible, where legal liabilities can be estimated and are considered probable, we have recorded a liability. To the extent that an insurance company is contractually obligated to reimburse us for a liability, we record a receivable for the amount of the probable reimbursement. We have established reserves for our contingent legal and regulatory liabilities in the amount of \$5.9 million at

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September 28, 2007 and \$6.6 million at December 29, 2006. We believe that none of the currently pending legal proceedings, individually or in the aggregate, will have a material adverse impact on our financial position, results of operations or cash flows beyond amounts that have been accrued in the financial statements, although we can make no assurances in this regard.

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On July 29, 2002, Marisol Balanderan and 55 other plaintiffs filed an action against us and one of our customers in California State Court, Los Angeles County. The plaintiffs are temporary employees and job applicants who seek unquantified compensatory and punitive damages based on allegations that they were subjected to discrimination in dispatch to jobs on the basis of their female gender, throughout a period from September 2001 through January 2002. On April 26, 2007, the parties entered into a settlement agreement which resolved all outstanding claims. On August 6, 2007, the Court issued final approval of the settlement. All amounts related to settlement are accounted for in our established reserves for our contingent legal and regulatory liabilities.

On July 16, 2003, Alecia Recio, Elizabeth Esquivel, Debbie Owen and Barry Selbts, each a current or former Labor Ready employee, jointly filed an action in United States District Court for the Central District of California, alleging failure to pay overtime under state and federal law and seeking unspecified damages and certification of a class of similarly situated employees (this matter now includes the claims of Scott Romer and Shawna Clark previously pursued in a separate action). On September 23, 2003, the court dismissed the case for improper venue. On October 1, 2003, Recio re-filed her case in California State Court, Los Angeles County, seeking similar relief on behalf of Labor Ready employees employed in the State of California. On December 14, 2006 the Court denied our motion to transfer venue to the United States District Court for the Western District of Washington. The case went to mediation on September 27, 2007 and on October 12, 2007. Subsequently, the parties entered into a settlement which resolved all claims. The settlement is subject to court approval. All amounts related to settlement are accounted for in our established reserves for our contingent legal and regulatory liabilities.

On January 12, 2005, the New Jersey Division of Taxation (the Division) filed a Notice of Assessment Related to Final Audit Determination asserting that we owe \$7.0 million for delinquent sales taxes, penalties and interest for the period October 1, 2000 through September 30, 2004. The amount of the assessment is based on the Division's assertion that 100% of our revenue from New Jersey operations is subject to sales tax. We disputed the Division's position that we provide taxable services under New Jersey law and filed an administrative protest. The administrative protest was handled internally by the Division and did not involve any outside or independent governmental bodies. On September 19, 2006, the Division issued a final determination increasing the amount that we allegedly owe for delinquent sales taxes, penalties and interest to \$8.1 million. Interest continues to accrue on this amount. We have now sought independent review of this determination by filing a complaint with the Tax Court of New Jersey on December 15, 2006. A trial date had previously been set for October 10, 2007. The Tax Court of New Jersey has postponed the trial date to a date to be determined. This matter is currently in the discovery phase.

NOTE 9: STOCK BASED COMPENSATION

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We account for stock-based compensation under the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised), *Share-Based Payment*, using the modified-prospective transition method. Under this transition method, we recognize stock-based compensation expense for stock-based awards granted subsequent to the year ended December 30, 2005 in accordance with the provisions of SFAS No. 123R, and the estimated expense for the portion vesting in the period for options granted prior to, but not vested as of December 30, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. Compensation cost for all stock-based awards is recognized using the straight-line method.

Total stock-based compensation expense recognized in the consolidated financial statements for the thirteen weeks ended September 28, 2007 was \$1.5 million, before income taxes, compared to total stock-based compensation expense for the thirteen weeks ended September 29, 2006 of \$1.2 million, before income taxes. Total stock-based compensation expense recognized in the consolidated financial statements for the thirty-nine weeks ended September 28, 2007 was \$5.5 million, before income taxes, compared to total stock-based compensation expense for the thirty-nine weeks ended September 29, 2006 of \$5.1 million, before income taxes.

Stock options

We have stock option and incentive plans for directors, officers, and employees, which provide for nonqualified stock options and incentive stock options. We issue new shares of common stock upon exercise of stock options. The majority of our stock options vest evenly over a four-year period from the date of grant and expire if not exercised within five years from the date of grant. The maximum contractual term for our outstanding stock option awards is ten years.

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A summary of the weighted average assumptions and results for options granted during the periods presented is as follows:

| | Thirty-nine Weeks Ended | |
|--|--------------------------------|-------------------------------|
| | September 28, 2007 | September 29, 2006 |
| Expected life (in years) | 3.48 | 3.48 |
| Expected volatility | 40.5% | 43.5% |
| Risk-free interest rate | 4.9% | 4.3% |
| Expected dividend yield | 0.0% | 0.0% |
| Weighted average fair value of options granted during the period | \$6.74 | \$7.80 |

Stock option activity follows (shares in thousands):

| | Thirty-nine Weeks Ended September 28, 2007 | |
|--------------------------------------|---|----------------------|
| | Shares | (1) Price |
| Outstanding at beginning of period | 1,207 | \$ 13.93 |
| Granted | 257 | \$ 18.98 |
| Exercised | (351) | \$ 9.75 |
| Forfeited | (31) | \$ 11.58 |
| Expired | (17) | \$ 15.98 |
| Outstanding at the end of the period | 1,065 | \$ 16.57 |
| Exercisable at the end of the period | 575 | \$ 15.20 |

(1) Weighted average exercise price.

As of September 28, 2007, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$2.3 million, which is expected to be recognized over a weighted average period of 1.8 years through 2011.

As of September 28, 2007, total unrecognized stock-based compensation expense related to nonvested stock options

Restricted Stock

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Restricted stock is granted to certain key employees and vests over periods ranging from three to four years. A retention period following vesting of two to four years is in place for a certain percentage of shares granted to executive officers. The shares are not subject to forfeiture during the retention period and cannot be sold. Compensation cost of restricted stock is calculated based on the grant-date market value. We recognize compensation cost on a straight line basis over the vesting period for the awards that are expected to vest.

Restricted stock activity follows (shares in thousands):

| | Thirty-nine Weeks Ended September 28, 2007 | |
|------------------------------------|---|----------------------|
| | Shares | (1) Price |
| Nonvested at beginning of period | 467 | \$ 19.89 |
| Granted | 355 | \$ 20.04 |
| Vested | (153) | \$ 18.95 |
| Forfeited | (47) | \$ 19.76 |
| Nonvested at the end of the period | 622 | \$ 20.21 |

(1) Weighted average market price on grant date.

As of September 28, 2007, total unrecognized stock-based compensation expense related to non-vested restricted stock was approximately \$10.4 million, which is expected to be recognized over a weighted average period of 1.8 years through 2011.

Employee stock purchase plan

Our Employee Stock Purchase Plan (the ESPP) provides substantially all permanent employees who have completed six months of service and meet certain limited qualifications, an opportunity to purchase shares of our common stock through payroll deductions. The ESPP permits payroll deductions up to 10% of eligible after-tax compensation. Participant account balances are used to purchase shares of common stock at the lesser of 85% of the fair market value of shares on either the first day or the last day of each month. Under the Plan, 1.9 million shares of common stock have been reserved for purchase under the ESPP, of which 1.4 million shares have been issued and 0.5 million shares remain available for future issuance. The ESPP expires on June 30, 2008. During the thirty-nine weeks ended September 28, 2007 and September 29, 2006, participants purchased 63,000 and 60,000 shares in the ESPP for cash proceeds of \$1.1 million and \$1.1 million, respectively.

We consider our ESPP to be compensatory under SFAS No. 123R and accordingly we recognize compensation expense over the requisite service period for stock purchases made under the plan. The requisite service period is one month and begins on the enrollment date and ends on the purchase date.

NOTE 10: STOCK REPURCHASE

Under our authorized share repurchase program, we purchased and retired 7.5 million shares of our common stock during the thirty-nine weeks ended September 28, 2007 for a total amount of \$148.2 million, including commissions. As of September 28, 2007 we had \$39.6 million worth of common stock available to us for future repurchases under the current authorization. Under our authorized share repurchase program, we purchased and retired 2.7 million shares of our common stock for a total amount of \$59.9 million during the thirty-nine week period ended September 29, 2006.

NOTE 11: INCOME TAXES

We adopted the provisions of FIN 48 on December 30, 2006, the first day of our 2007 fiscal year. At adoption our liability for unrecognized tax benefits was \$1.9 million, including interest and penalties. As of September 28, 2007 there have been no material changes in our measurement of identified income tax positions. We do not expect that our liability for unrecognized tax benefits will significantly change within 12 months of the current period end.

We recognize interest and penalties related to uncertain tax positions in Income tax expense. Amounts for accrued interest and penalties were not material.

In general, the tax years 2002-2006 remain open to examination by the major taxing jurisdictions where we conduct business.

NOTE 12: COMPREHENSIVE INCOME

Our comprehensive income is made up of net income, foreign currency translation adjustment, net of tax and unrealized gain or loss on marketable securities. The following is a summary of comprehensive income (in thousands):

| | Thirteen Weeks Ended | | Thirty-Nine Weeks Ended | |
|---|-------------------------------|-------------------------------|--------------------------------|-------------------------------|
| | September 28, 2007 | September 29, 2006 | September 28, 2007 | September 29, 2006 |
| Net income | \$ 22,723 | \$ 24,828 | \$ 51,844 | \$ 54,910 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustment, net of tax | 1,264 | (14) | 1,547 | 498 |
| Unrealized gain (loss) on marketable securities | 5 | 26 | (8) | 41 |
| Other comprehensive income | 1,269 | 12 | 1,539 | 539 |
| Comprehensive income | \$ 23,992 | \$ 24,840 | \$ 53,383 | \$ 55,449 |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q contains forward-looking statements. These statements relate to our expectations for future events and future financial performance. Generally, the words anticipate, expect, intend and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. These statements are only predictions. Actual events or results may differ materially. Factors which could affect our financial results are described in Part 1 of our Form 10-K for the year ended December 29, 2006. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. We undertake no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

Executive Overview

Labor Ready is an international provider of blue-collar staffing with three business lines including general labor, light industrial, and skilled trades. We operate under the brand names of Labor Ready for our general labor business line; Spartan Staffing for our light industrial business line; and CLP Resources for our skilled trades business line. Our customers are primarily small to mid-sized businesses in various industries. Annually, we serve more than 300,000 customers and put approximately 600,000 people to work. At the end of September 28, 2007 we had 919 branches located in all 50 of the United States, Canada, Puerto Rico and the United Kingdom.

Revenue for the thirteen weeks ended September 28, 2007 of \$390.7 million increased 4.4% compared to \$374.1 million for the same period in 2006. Net income for the thirteen weeks ended September 28, 2007 of \$22.7 million decreased 8.5% compared to net income of \$24.8 million for the same period in 2006. The increase in revenue was primarily the result of the acquisition of Skilled Services Corporation (SSC) in April 2007 and, to a lesser extent, organic growth from existing business lines. Gross margin decreased to 32.1% for the thirteen weeks ended September 28, 2007 compared to 32.3% for the same period last year. The decrease in gross margin was primarily due to an increase in temporary worker wages as a percentage of revenue offset by a decrease in workers' compensation expense. The increase in temporary worker wages as a percentage of revenue is largely due to an increase in pay rates to our temporary workers as a result of various statutory minimum wage increases. While we have increased the bill rates to our customers for these pay increases, we have not yet fully passed through the amount of our standard markup due to an increased level of price sensitivity with our customers associated with slower economic conditions. The improvement in workers' compensation expense is related to a variety of accident prevention and risk management programs that have been implemented over several years. Selling, general and administrative (SG&A) expenses as a percentage of revenue were 22.8% of revenue for the thirteen weeks ended June 29, 2007 compared to 21.9% for the same period in 2006. The increase in SG&A as a percentage of revenue during the current year period is primarily due to expenses related to closed branches, expenses related to new branches opened during the past 12 months and sales development costs. In response to the continued decline in demand in industrial staffing, we have scaled back the number of new branch openings in 2007 and have closed underperforming branches.

Revenue for the thirty-nine weeks ended September 28, 2007 of \$1.03 billion increased 2.1% compared to \$1.01 billion for the same period in 2006. Net income for the thirty-nine weeks ended September 28, 2007 of \$51.8 million decreased 5.6% compared to net income of \$54.9 million for the same period in 2006. Revenue for the thirty-nine weeks ended September 28, 2007 was slightly higher than the comparable period due to the acquisition of SSC in April 2007. Organic growth from our core operations was nearly flat due to negative same branch revenue trends earlier in the year and an increase in lost revenue from branch closures that continued through the thirty-nine week period. Gross margin remained steady at 32.0% for the thirty-nine weeks ended September 28, 2007 compared to 32.0% for the same period last year. Lower workers' compensation expense was offset by increased wage and pricing pressure. The improvement in workers' compensation expense is primarily due to improvements in accident prevention and risk management. Wage pressure to our temporary workers was heavily driven by numerous statutory minimum wage increases. While we have increased the bill rates to our customers for these pay increases, we have not yet

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fully passed through the amount of our standard markup due to an increased level of price sensitivity with our customers associated with slower economic conditions. Selling, general and administrative (SG&A) expenses as a percentage of revenue were 24.1% of revenue for the thirty-nine weeks ended September 28, 2007 compared to 23.3% for the same period in 2006. The increase in SG&A as a percentage of revenue is largely due to lack of organic revenue growth, expenses related to newly opened branches, branch closure costs, and sales development expenses.

Page - 15

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Net income was \$0.51 per diluted share for the thirteen weeks ended September 28, 2007 compared to net income per diluted share of \$0.48 for the thirteen weeks ended September 29, 2006. Net income was \$1.11 per diluted share for the thirty-nine weeks ended September 28, 2007 compared to net income per diluted share of \$1.03 for the same period in 2006. The increase in net income per diluted share in both periods can be attributed to our share repurchases which have resulted in a decrease in our weighted average shares outstanding. During the thirteen weeks ended September 28, 2007, we purchased approximately 2.5 million shares of our common stock for \$53.4 million, including commissions. Since the beginning of 2006 we have purchased approximately 11.7 million shares of our common stock at a cost of \$237.0 million, including commissions.

In addition to various state minimum wage increases that occurred earlier in the year, the federal minimum wage increased on July 24, 2007 from \$5.15 per hour to \$5.85. In those instances where our temporary employees are making less than the minimum wage, we have increased their pay rates. Similarly, our approach is to increase our customer bill rates to include the amount of any pay increase to our temporary employees as well as our standard markup on pay rates. While we intend to pass the pay rate increases and our standard markup through to our customers, we have not been able to fully do so with all statutory minimum wage increases. Consequently, we may encounter similar difficulty in passing through our standard markup with future minimum wage increases.

Results of Operations

Thirteen Weeks Ended September 28, 2007 Compared to Thirteen Weeks Ended September 29, 2006

The following table compares the operating results for the thirteen weeks ended September 28, 2007 and September 29, 2006 (in thousands):

| | September 28, 2007 | | Thirteen Weeks Ended September 29, 2006 | | Change from 2006 | |
|-------------------------------|--------------------|-----------------|--|-----------------|------------------|---------|
| | Amount | % of Revenue | Amount | % of Revenue | Amount | % |
| Revenue from services | \$390,672 | 100.0% | \$374,126 | 100.0% | \$16,546 | 4.4% |
| Cost of services | 265,168 | 67.9% | 253,262 | 67.7% | 11,906 | 4.7% |
| Gross profit | 125,504 | 32.1% | 120,864 | 32.3% | 4,640 | 3.8% |
| SG&A expenses | 89,077 | 22.8% | 81,790 | 21.9% | 7,287 | 8.9% |
| Depreciation and amortization | 3,402 | 0.9% | 2,441 | 0.7% | 961 | 39.4% |
| Interest expense | (116) | (0.0%) | (149) | (0.0%) | (33) | (22.1%) |
| Interest and other income | 2,620 | 0.7% | 3,167 | 0.8% | (547) | (17.3%) |
| Income before tax expense | 35,529 | 9.1% | 39,651 | 10.6% | (4,122) | (10.4%) |
| Net income | \$22,723 | 5.8% | \$24,828 | 6.6% | \$(2,105) | (8.5%) |

Branch Offices and Revenue from Services. The number of branch offices decreased to 919 at September 28, 2007. We opened 6 branch offices and closed 19 branch offices during the thirteen weeks ended September 28, 2007. We also announced plans to close 16 branches during the thirteen week period ending December 28, 2007. Revenue for the thirteen weeks ended September 28, 2007 increased 4.4% compared to the same quarter a year ago. The change in revenue was made up of the following five components: (a) a 1.2% increase in same store branch revenue, defined as those branches opened one year or longer, (b) a (1.4%) decline in revenue related to branches closed over the past twelve months, (c) a 3.0% increase due to the acquisition of SSC (d) a 1.1% increase in revenue from new branches opened less than one year and (e) a 0.5% increase from other miscellaneous factors.

Cost of Services and Gross Profit. Cost of services was 67.9% of revenue for the thirteen weeks ended September 28, 2007 compared to 67.7% for the thirteen weeks ended September 29, 2006. Cost of services increased slightly as a percentage of sales primarily due to the increase in wages paid to temporary workers. The increase in temporary worker wages as a percentage of revenue is largely due to an increase in pay rates to our temporary workers as a result of various statutory minimum wage increases in certain jurisdictions where we conduct business. We have experienced 50 statutory minimum wage increases in U.S. states and territories and Canadian provinces, 24 of which went into effect in the third quarter of 2007. While we have increased the bill rates to our customers for these pay increases, we have not yet fully passed through the amount of our standard markup due to an increased level of price sensitivity with our customers associated with slower economic conditions. As a result, our average pay rate increased 4.4% while our average bill rate increased 2.4%. This increase was partially offset by lower workers compensation costs. Workers compensation costs for the thirteen weeks ended September 28, 2007 were approximately 4.7% of revenue compared to 5.7% in the thirteen weeks ended September 29, 2006. The improvement in workers compensation expense is related to a variety of accident prevention and risk management programs that have been implemented over the past several years.

Selling, General, and Administrative Expenses. Selling, general and administrative (SG&A) expenses as a percentage of revenue were 22.8% for the thirteen weeks ended September 28, 2007 compared to 21.9% for the thirteen weeks ended September 29, 2006. SG&A expenses were higher as a percentage of revenue primarily as a result of expenses related to branch closures, costs of opening new branches and sales development expenses. We accrued \$1.3 million of branch closure costs related to 35 branch closures, 19 of which were closed during the third quarter of 2007 and 16 closures planned for the fourth quarter of 2007. The majority of the closed branches have been or will be consolidated with a nearby local branch and all but three of the branches are part of the Labor Ready brand. We have opened a total of 21 branches during 2007.

Depreciation and Amortization Expenses. Depreciation and amortization expenses increased to \$3.4 million for the thirteen weeks ended September 28, 2007 from \$2.4 million for the thirteen weeks ended September 29, 2006. The increase is primarily due to additional amortization on intangible assets as a result of the SSC acquisition in April 2007.

Interest and Other Income, net. Interest and other income, net was \$2.5 million for the thirteen weeks ended September 28, 2007 compared to \$3.0 million for the thirteen weeks ended September 29, 2006. During 2007 we have used cash to purchase our common stock and for the acquisition of SSC which has resulted in a decrease in the amount of cash available for investment.

Income Tax Our effective tax rate on earnings for the thirteen weeks ended September 28, 2007 was 36.0%, compared to 37.4% for the thirteen weeks ended September 29, 2006. The principal difference between the statutory federal income tax rate of 35.0% and our effective income tax rate results from state income taxes, federal tax credits, tax exempt interest income, and certain non-deductible expenses. The decrease in our effective tax rate reflects the tax benefit from the Work Opportunity Tax Credit that is in effect during 2007 but was not in effect at this same time in 2006.

Results of Operations

Thirty-Nine Weeks Ended September 28, 2007 Compared to Thirty-Nine Weeks Ended September 29, 2006

The following table compares the operating results for the thirty-nine weeks ended September 28, 2007 and September 29, 2006 (in thousands):

| | September 28, 2007 | | Thirty-Nine Weeks Ended September 29, 2006 | | Change from 2006 | |
|-----------------------|--------------------|-----------------|---|-----------------|------------------|------|
| | Amount | % of Revenue | Amount | % of Revenue | Amount | % |
| Revenue from services | \$1,032,040 | 100.0% | \$1,010,970 | 100.0% | \$21,070 | 2.1% |
| Cost of services | 701,858 | 68.0% | 687,738 | 68.0% | 14,120 | 2.1% |

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| | | | | | | |
|-------------------------------|----------|--------|----------|--------|-----------|--------|
| Gross profit | 330,182 | 32.0% | 323,232 | 32.0% | 6,950 | 2.2% |
| SG&A expenses | 248,355 | 24.1% | 235,523 | 23.3% | 12,832 | 5.4% |
| Depreciation and amortization | 8,661 | 0.8% | 7,909 | 0.8% | 752 | 9.5% |
| Interest expense | (803) | (0.1%) | (582) | (0.1%) | 221 | 38.0% |
| Interest and other income | 9,026 | 0.9% | 9,347 | 0.9% | (321) | (3.4%) |
| Income before tax expense | 81,389 | 7.9% | 88,565 | 8.8% | (7,176) | (8.1%) |
| Net income | \$51,844 | 5.0% | \$54,910 | 5.4% | \$(3,066) | (5.6%) |

Branch Offices and Revenue from Services. The number of branch offices decreased to 919 at September 28, 2007. We opened 21 branch offices, acquired 17 SSC branch offices and closed 31 branch offices during the thirty-nine weeks ended September 28, 2007. We also announced plans to close 16 branches during the thirteen week period ending December 28, 2007. Revenue for the thirty-nine weeks ended September 28, 2007 increased 2.1% compared to the same period a year ago. The change in revenue was made up of the following four components: (a) a (0.2%) decrease in same store branch revenue, defined as those branches opened one year or longer, (b) a (1.3%) decline in revenue related to branches closed over the past twelve months, (c) a 1.9% increase due to the acquisition of SSC (d) a 1.3% increase in revenue from new branches opened less than one year and (e) a 0.4% increase from other miscellaneous factors.

Cost of Services and Gross Profit. Cost of services was 68.0% of revenue for the thirty-nine weeks ended September 28, 2007 compared to 68.0% for the thirty-nine weeks ended September 29, 2006. Workers' compensation costs for the thirty-nine weeks ended September 28, 2007 were approximately 4.9% of revenue compared to 5.8% in the thirty-nine weeks ended September 29, 2006. The improvement in workers' compensation expense is related to a variety of accident prevention and risk management programs that have been implemented over several years. The decrease in workers' compensation costs was partially offset by an

increase in wages paid to temporary workers. We have experienced 50 statutory minimum wage increases in U.S. states and territories and Canadian provinces, 24 of which went into effect in the third quarter of 2007. While we have increased the bill rates to our customers for these pay increases, we have not yet fully passed through our standard markup due to an increased level of price sensitivity with our customers associated with slower economic conditions. As a result, our average pay rate increased 4.2% while our average bill rate increased 2.6%.

Selling, General, and Administrative Expenses. Selling, general and administrative (SG&A) expenses as a percentage of revenue were 24.1% for the thirty-nine weeks ended September 28, 2007 compared to 23.3% for the thirty-nine weeks ended September 29, 2006. The increase in SG&A as a percentage of revenue is largely due to lack of organic revenue growth, expenses related to newly opened branches, branch closure costs, and sales development expenses. For the thirty-nine weeks ended September 28, 2007, we have accrued expenses for 47 branch closures year-to-date, which include a known 16 branch closures planned for the fourth quarter of 2007.

Depreciation and Amortization Expenses. Depreciation and amortization expenses increased to \$8.7 million for the thirty-nine weeks ended September 28, 2007 from \$7.9 million for the thirty-nine weeks ended September 29, 2006. The increase during the current year period is due to an increase in our depreciable asset base compared to the prior year.

Income Tax Our effective tax rate on earnings for the thirty-nine weeks ended September 28, 2007 was 36.3%, compared to 38.0% for the thirty-nine weeks ended September 29, 2006. The principal difference between the statutory federal income tax rate of 35.0% and our effective income tax rate results from state income taxes, federal tax credits, tax exempt interest income, and certain non-deductible expenses. The decrease in our effective tax rate reflects the tax benefit from the Work Opportunity Tax Credit that is in effect during 2007 but was not in effect at this same time in 2006.

Liquidity and Capital Resources

Cash Flow Summary (This summary should be read in conjunction with the Consolidated Statements of Cash Flows in Item 1 of Part 1 of this Form 10-Q)

Cash Flows from Operating Activities

Net cash provided by operating activities was \$51.1 million for the thirty-nine weeks ended September 28, 2007. Net income totaled \$51.8 million for the thirty-nine weeks ended September 28, 2007. Cash provided by operating assets and liabilities includes increases in income taxes payable due to timing of estimated tax payments and increases in the workers' compensation reserve. These amounts were offset by an increase in accounts receivable associated with the seasonal aspect of our business.

Cash Flows from Investing Activities

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Net cash provided by investing activities was \$38.7 million for the thirty-nine weeks ended September 28, 2007. Cash provided by investing activities was primarily from net maturities of marketable securities of \$80.8 million. These inflows were mostly offset by cash used in the purchase of SSC in April 2007 for \$26.5 million, net of cash acquired and capital expenditures of \$16.3 million, primarily associated with investments in technology projects.

Cash Flows from Financing Activities

Net cash used in financing activities was \$143.7 million for the thirty-nine weeks ended September 28, 2007. Under our authorized share repurchase program, we purchased and retired 7.5 million shares of our common stock during the thirty-nine weeks ended September 28, 2007 for a total amount of \$148.2 million, including commissions. As of September 28, 2007 we had \$39.6 million worth of common stock available to us for future repurchases under the current authorization. Cash inflows from financing activities during the thirty-nine weeks ended September 28, 2007 were primarily related to net proceeds from our employee stock plans activity.

Capital Resources

We have an \$80.0 million credit agreement with certain unaffiliated financial institutions (the Revolving Credit Facility) that expires in November 2008. The Revolving Credit Facility, which is secured by substantially all our assets except our real estate, provides us with access to loan advances and letters of credit. The amounts we may borrow (our borrowing capacity) under this agreement are largely a function of the levels of our accounts receivable from time to time, supplemented by pledged collateral. Under the terms of the Revolving Credit Facility, we pay a variable rate of interest based on a margin above LIBOR for borrowings and a variable unused commitment fee, both based on a consolidated leverage ratio of consolidated total debt to consolidated EBITDA. Fees for letters of credit are based on the margin in effect plus a fee of 0.05%. As of September 28, 2007, our margin was 0.50% and our unused capacity fee was 0.15%. At September 28, 2007, we had \$33.9 million of letters of credit issued against that borrowing capacity leaving us with \$46.1 million available for future borrowings. The Revolving Credit Facility requires that we comply with certain financial covenants. Among other things, these covenants require us to

maintain certain leverage and coverage ratios. We are currently in compliance with all covenants related to the Revolving Credit Facility.

We have agreements with certain financial institutions through our wholly-owned and consolidated subsidiary, Workers Assurance of Hawaii, Inc. (our Workers Assurance Program), that allow us to restrict cash for the purpose of providing cash-backed instruments for our workers compensation collateral. These instruments include cash-backed letters of credit, cash held in trusts as well as cash deposits held by our insurance carriers. At September 28, 2007 we had restricted cash in our Workers Assurance Program totaling \$137.3 million. Of this cash, \$132.8 million was committed to insurance carriers leaving \$4.5 million available for future needs.

We believe that cash provided from our operations and our capital resources will be adequate to meet our cash requirements over the next twelve months.

Workers Compensation Collateral and Claims Reserves

We provide workers compensation insurance for our temporary and permanent employees. Our workers compensation insurance policies must be renewed annually. Our current coverage with American International Group, Inc. (AIG) is for occurrences during the period from July 2007 through July 2008. While we have primary responsibility for all claims, our insurance coverage provides reimbursement for certain losses and expenses beyond the deductible limits. For workers compensation claims originating in self-insured states, the majority of our current workers compensation insurance policies cover claims for a particular event above a \$2.0 million deductible, on a per occurrence basis. This results in our being substantially self-insured. Furthermore, we have full liability for all further payments on claims which originated between January 2001 and June 2003, without recourse to any third party insurer as the result of a novation agreement we entered into with Kemper Insurance Company in December 2004.

We are required by our insurance carriers and certain state workers compensation programs to collateralize a portion of our workers compensation obligation with cash and cash-backed instruments, irrevocable letters of credit, or surety bonds. In connection with the renewal of our policy, insurance carriers annually assess the amount of collateral they will require from us relative to our workers compensation obligation for which they become responsible should we become insolvent. Such amounts can increase or decrease independent of our assessments and reserves.

The amount of collateral that our insurance carrier required us to post for our annual renewal at July 1, 2007 was substantially less than the previous year. To the extent that our insurance carrier's initial requirement was underestimated, we could be required to post substantially more collateral in the future.

At September 28, 2007 and December 29, 2006 we had provided our insurance carriers and certain states with commitments in the form and amounts outlined below (in millions):

| | Workers Compensation Commitments as of: | |
|-------------------------------|--|------------------------------|
| | September 28, 2007 | December 29, 2006 |
| Workers Assurance Program (1) | \$ 132.8 | \$ 138.7 |
| Letters of credit | 33.9 | 45.5 |

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| | | |
|-------------------------------|----------|----------|
| Surety bonds (2) | 16.9 | 17.6 |
| Other cash backed instruments | 1.1 | 0.6 |
| Total Collateral Commitments | \$ 184.7 | \$ 202.4 |

(1) We have agreements with certain financial institutions through our wholly-owned and consolidated subsidiary, Workers Assurance of Hawaii, Inc. (our Workers Assurance Program), that allow us to restrict cash for the purpose of providing cash-backed instruments for our workers compensation collateral.

(2) We had \$4.0 million and \$3.8 million of restricted cash collateralizing our surety bonds at September 28, 2007 and December 29, 2006, respectively.

Our surety bonds are issued by independent insurance companies on our behalf and bear annual fees based on a percentage of the bond, which is determined by each independent surety carrier, but do not exceed 2.0% of the bond amount, subject to a minimum charge. The terms of these bonds are subject to review and renewal every one to four years and most bonds can be canceled by the sureties with as little as 60 days notice.

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Our Workers Assurance Program cash and cash-backed instruments include cash-backed letters of credit, cash held in trusts and cash deposits held by our insurance carriers. The fees related to those instruments subject to an annual fee were approximately 0.57% as of September 28, 2007.

The following table provides a reconciliation of our collateral commitments to our workers compensation reserve as of the period end dates presented (in millions):

| | September 28, 2007 | December 29, 2006 |
|---|-------------------------------|------------------------------|
| Ending workers compensation reserve: | \$ 196.7 | \$ 189.4 |
| a) Discount on reserves | 44.5 | 41.3 |
| b) Timing of collateral release with prior providers | (2.7) | 13.0 |
| c) Collateral posted with current provider in comparison to obligation incurred | (30.5) | (19.4) |
| d) Reserves for claims above our deductible (excess claims), net of discount | (23.3) | (21.9) |
| Total Collateral Commitments | \$ 184.7 | \$ 202.4 |

Our total collateral commitments differ from our workers compensation reserve due to several factors including the following which are reconciled above: (a) our claims reserves are discounted to their estimated net present value while our collateral commitments are based on the gross, undiscounted reserve; (b) a delay in the release of collateral posted with prior insurance companies for claims that have been previously paid and, therefore, are no longer reflected in the reserve; (c) collateral posted with the current insurance carrier and various state entities in comparison to the estimated balance of unpaid claims which can be influenced by their perception of our credit risk; and (d) discounted reserves for claims above our deductible.

Generally, our workers compensation reserve for estimated claims increases as temporary labor services are provided and decreases as payments are made on these claims. Although the estimated claims are expensed as incurred, the claim payments are made over a weighted average period of approximately six years. Collateral for our workers compensation program is posted with various state workers compensation programs and insurance carriers based upon their assessments of our potential liabilities. Due to the timing difference between the recognition of expense and claim payments as described above, we generally anticipate that both our reserves and our collateral obligations will continue to grow.

Our workers compensation reserve is established using estimates of the future cost of claims and related expenses that have been reported but not settled, as well as those that have been incurred but not reported. Throughout the year, management reviews and evaluates the adequacy of reserves for prior periods on a quarterly basis in conjunction with an independent actuarial assessment. We maintain reserves for workers compensation claims, including the excess claims portion above our deductible, using actuarial estimates of the future cost of claims and related expenses. Adjustments to prior period reserves are charged or credited to expense in the periods in which the estimate changes. Our claims reserves are discounted to their estimated net present value using discount rates based on average returns of risk-free U.S. Treasury instruments with maturities comparable to the weighted average lives of our workers compensation claims. At September 28, 2007 our reserves are discounted at rates ranging from 4.39% to 6.01%.

Factors we consider in establishing and adjusting these reserves include the estimates provided by our independent actuaries, appropriate discount rates and estimated payment patterns. Factors that have caused our estimated losses for prior years to change include, among other things, (a) inflation of medical and indemnity costs at a rate higher than originally anticipated, (b) regulatory and legislative developments that have increased benefits and settlement requirements in several states, (c) a different mix of business than previously anticipated, (d) the impact of safety initiatives implemented, and (e) positive or adverse development of claim reserves.

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The following table provides an analysis of changes in our workers' compensation claims reserves (in thousands). Changes in reserve estimates are reflected in the income statement for the period when the changes in estimates are made.

| | (Amounts in Thousands) | | | |
|---|------------------------|-----------------------|-------------------------|-----------------------|
| | Thirteen Weeks Ended | | Thirty-nine Weeks Ended | |
| | September 28, 2007 | September 29, 2006 | September 28, 2007 | September 29, 2006 |
| Beginning balance | \$ 192,289 | \$ 178,319 | \$ 189,435 | \$ 167,859 |
| Self-insurance reserve expense | | | | |
| Expenses related to current year (net of discount) | 17,477 | 18,423 | 47,140 | 51,392 |
| Change related to prior years (net of discount) (1) | (2,967) | (2,063) | (12,304) | (7,054) |
| Total | 14,510 | 16,360 | 34,836 | 44,338 |
| Amortization of prior years' discount (1) | (142) | (197) | 796 | 702 |
| Payments | | | | |
| Payments related to current year claims | (3,644) | (3,200) | (6,341) | (5,834) |
| Payments related to claims from prior years | (6,786) | (6,575) | (24,992) | (24,275) |
| Total | (10,430) | (9,775) | (31,333) | (30,109) |
| Net change in excess claims reserve | 104 | 720 | 1,322 | 2,637 |
| SSC liability assumed, net of discount | 404 | - | 1,679 | - |
| Ending balance | 196,735 | 185,427 | 196,735 | 185,427 |
| Less current portion | 51,909 | 49,089 | 51,909 | 49,089 |
| Long-term portion | \$ 144,826 | \$ 136,338 | \$ 144,826 | \$ 136,338 |

(1) We had previously included all amortization of discount related to reserves established in prior years in the "Amortization of prior years' discount" line in the table above. This line included the amortization of discount related to any changes in prior years' reserve as well as amortization of discount related to the passage of time. We have since modified our disclosure to include the amortization of discount related to any changes in prior years' reserve in the "Change related to prior years (net of discount)" line above. We believe this provides more clarity on the impact, net of discount, to our financial results from any changes related to reserves established in prior years.

Other

Included in cash and cash equivalents at September 28, 2007 and December 29, 2006 is cash held within branch CDMs for payment of temporary payrolls in the amount of \$15.0 million and \$19.6 million, respectively.

Our capital expenditures were \$16.3 million and \$10.4 million for the thirty-nine weeks ended September 28, 2007 and September 29, 2006, respectively. The increase over the prior year period is primarily due to expenditures for technology projects. We anticipate total capital expenditures for 2007 to be approximately \$19 million.

Contractual Obligations and Commitments

We have various contractual obligations that are recorded as liabilities in our consolidated financial statements. Certain contractual obligations, such as operating lease obligations, are not recognized as liabilities in our consolidated financial statements, but are required to be disclosed. There were no material changes outside the ordinary course of business in our contractual obligations during the thirty-nine week period ended September 28, 2007.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Management does not believe that there is any material market risk exposure with respect to our financial instruments that would require disclosure under this item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our CEO and our CFO concluded that, as of September 28, 2007, our disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting. During the thirteen weeks ended September 28, 2007, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

See Note 8 of Notes to Consolidated Financial Statements found in Item 1 of Part I of this Form 10-Q.

Item 1A. Risk Factors

There have been no material changes in the risk factors set forth in our Annual Report on Form 10-K for fiscal 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

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The table below includes repurchases of our common stock pursuant to publicly announced plans or programs and those not made pursuant to publicly announced plans or programs during the thirteen weeks ended September 28, 2007.

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Under our authorized share repurchase program, we purchased and retired 7.5 million shares of our common stock during the thirty-nine weeks ended September 28, 2007 for a total amount of \$148.2 million, including commissions. As of September 28, 2007 we had \$39.6 million worth of common stock available to us for future repurchases under the current authorization. We purchased and retired 2.7 million shares of our common stock for a total amount of \$59.9 million during the thirty-nine week period ended September 29, 2006.

| Period | Total number of shares purchased (1) | Weighted average price paid per share (2) | Total number of shares purchased as part of publicly announced plans for programs (1) | Maximum number of shares (or approximate dollar value) that may yet be purchased under plans or programs at period end |
|-------------------------|---|--|--|---|
| 6/30/07 through 7/27/07 | 84,771 | \$22.94 | 83,900 | \$91.0 million |
| 7/28/07 through 8/24/07 | 2,384,018 | \$21.57 | 2,383,431 | \$39.6 million |
| 8/25/07 through 9/28/07 | 1,410 | \$20.27 | | \$39.6 million |
| Total | 2,470,199 | \$21.62 | 2,467,331 | |

(1) During the thirteen weeks ended September 28, 2007, we purchased 2,868 shares in order to satisfy employee tax withholding obligations upon the vesting of restricted stock. These shares were not acquired pursuant to any repurchase plan or program.

(2) Weighted average price paid per share does not include any adjustments for commissions.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibits

- 31.1 Certification of Steven C. Cooper, Chief Executive Officer of Labor Ready, Inc., Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 31.2 Certification of Derrek L. Gafford, Chief Financial Officer of Labor Ready, Inc., Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 32.1 Certification of Steven C. Cooper, Chief Executive Officer of Labor Ready, Inc. and Derrek L. Gafford, Chief Financial Officer of Labor Ready, Inc., Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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