

LABOR READY INC  
Form 10-Q  
May 04, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended: March 30, 2007

**or**

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

Commission File Number: 001-14543

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**LABOR READY, INC.**

(Exact name of Registrant as specified in its charter)

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**Washington**

(State or other jurisdiction of  
incorporation or organization)

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

**91-1287341**  
(IRS Employer  
Identification No.)

**98402**  
(Zip Code)

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

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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 April 27, 2007, there were 46,419,810 shares of the registrant's common stock outstanding.

**Documents incorporated by reference: None.**

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**LABOR READY, INC.**

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**PART I. Financial Information****Item 1. Financial Statements****LABOR READY, INC.****CONSOLIDATED BALANCE SHEETS**

In Thousands

**ASSETS**

|  | <b>March 30,<br/>2007<br/>(Unaudited)</b> | <b>December 29,<br/>2006</b> |
|--|---|------------------------------|
| <b>CURRENT ASSETS:</b>                         |   |                              |
| Cash and cash equivalents                      | \$ 59,796                                 | \$ 107,944                   |
| Marketable securities                          | 83,822                                    | 91,510                       |
| Accounts receivable                            | 119,205                                   | 125,282                      |
| Allowance for doubtful accounts                | (4,456                                    | ) (5,109                     |
| Prepaid expenses, deposits and other           | 13,578                                    | 15,651                       |
| Income tax receivable                          | -   | 2,229                        |
| Deferred income taxes                          | 4,134                                     | 2,251                        |
| Total current assets                           | 276,079                                   | 339,758                      |
| <b>PROPERTY AND EQUIPMENT:</b>                 |   |                              |
| Buildings and land                             | 22,149                                    | 21,505                       |
| Computers and software                         | 44,450                                    | 39,341                       |
| Cash dispensing machines                       | 14,268                                    | 14,280                       |
| Furniture and equipment                        | 8,551                                     | 8,345                        |
|  | 89,418                                    | 83,471                       |
| Less accumulated depreciation and amortization | 53,275                                    | 51,522                       |
| Property and equipment, net                    | 36,143                                    | 31,949                       |
| <b>OTHER ASSETS:</b>                           |   |                              |
| Restricted cash and other assets               | 145,622                                   | 143,731                      |
| Deferred income taxes                          | 4,883                                     | 6,972                        |
| Goodwill                                       | 37,364                                    | 37,364                       |
| Other assets, net                              | 30,270                                    | 32,532                       |
| Total other assets                             | 218,139                                   | 220,599                      |
| Total assets                                   | \$ 530,361                                | \$ 592,306                   |

See accompanying notes to consolidated financial statements

## LABOR READY, INC.

## CONSOLIDATED BALANCE SHEETS

In Thousands (Except Par Values)

## LIABILITIES AND SHAREHOLDERS EQUITY

|   | March 30,<br>2007<br>(Unaudited) | December 29,<br>2006 |
|---|----------------------------------|----------------------|
| <b>CURRENT LIABILITIES:</b>   |                                  |                      |
| Accounts payable  | \$ 28,131                        | \$ 22,653            |
| Accrued wages and benefits  | 20,417                           | 25,596               |
| Current portion of workers' compensation claims reserve   | 49,669                           | 52,229               |
| Income tax payable  | 2,131                            | -                    |
| Other current liabilities   | 815                              | 907                  |
| <b>Total current liabilities</b>  | <b>101,163</b>                   | <b>101,385</b>       |
| <b>LONG-TERM LIABILITIES:</b>   |                                  |                      |
| Workers' compensation claims reserve, less current portion  | 138,178                          | 137,206              |
| Other non-current liabilities   | 1,251                            | 1,197                |
| <b>Total long-term liabilities</b>  | <b>139,429</b>                   | <b>138,403</b>       |
| <b>Total liabilities</b>  | <b>240,592</b>                   | <b>239,788</b>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                                  |                      |
| <b>SHAREHOLDERS' EQUITY:</b>  |                                  |                      |
| Preferred stock, \$0.131 par value, 20,000 shares authorized;<br>No shares issued and outstanding         |                                  |                      |
| Common stock, no par value, 100,000 shares authorized;<br>46,940 and 50,637 shares issued and outstanding | 3,248                            | 76,372               |
| Cumulative foreign currency translation adjustment, net of tax  | 2,749                            | 2,717                |
| Cumulative unrealized gain on marketable securities   | 6                                | 11                   |
| Retained earnings   | 283,766                          | 273,418              |
| <b>Total shareholders' equity</b>   | <b>289,769</b>                   | <b>352,518</b>       |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 530,361</b>                | <b>\$ 592,306</b>    |

See accompanying notes to consolidated financial statements

## LABOR READY, INC.

## CONSOLIDATED STATEMENTS OF INCOME

In Thousands (Except Per Share Data)

(Unaudited)

|  | Thirteen Weeks Ended |                   |
|--|----------------------|-------------------|
|  | March 30,<br>2007    | March 31,<br>2006 |
| Revenue from services                        | \$ 290,237           | \$ 297,067        |
| Cost of services                             | 197,446              | 204,150           |
| Gross profit                                 | 92,791               | 92,917            |
| Selling, general and administrative expenses | 77,376               | 74,224            |
| Depreciation and amortization                | 2,401                | 2,796             |
| Income from operations                       | 13,014               | 15,897            |
| Interest expense                             | (262 )               | (263 )            |
| Interest and other income                    | 3,544                | 3,009             |
| Interest and other income, net               | 3,282                | 2,746             |
| Income before tax expense                    | 16,296               | 18,643            |
| Income tax                                   | 5,948                | 7,177             |
| Net income                                   | \$ 10,348            | \$ 11,466         |
| Net income per common share:                 |                      |                   |
| Basic  | \$ 0.21              | \$ 0.21           |
| Diluted                                      | \$ 0.21              | \$ 0.21           |
| Weighted average shares outstanding:         |                      |                   |
| Basic  | 49,076               | 53,680            |
| Diluted                                      | 49,342               | 54,447            |

See accompanying notes to consolidated financial statements

**LABOR READY, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**In Thousands**

**(Unaudited)**

|   | <b>Thirteen Weeks Ended</b> |                           |
|---|-----------------------------|---------------------------|
|   | <b>March 30,<br/>2007</b>   | <b>March 31,<br/>2006</b> |
| Net income  | \$ 10,348                   | \$ 11,466                 |
| Other comprehensive income:                         |                             |                           |
| Foreign currency translation adjustment, net of tax | 32                          | 145                       |
| Unrealized (loss) gain on marketable securities     | (5 )                        | 9                         |
| Other comprehensive income                          | 27                          | 154                       |
| Comprehensive income                                | \$ 10,375                   | \$ 11,620                 |

See accompanying notes to consolidated financial statements

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## LABOR READY, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

In Thousands

(Unaudited)

|   | Thirteen Weeks Ended |                   |
|---|----------------------|-------------------|
|   | March 30,<br>2007    | March 31,<br>2006 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                      |                   |
| Net income  | \$ 10,348            | \$ 11,466         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                      |                   |
| Depreciation and amortization   | 2,401                | 2,796             |
| Provision for doubtful accounts   | 1,631                | 1,598             |
| Deferred income taxes   | 229                  | (7,763)           |
| Stock-based compensation  | 2,356                | 2,497             |
| Excess tax benefits from stock-based compensation                                 | (418)                | (1,877)           |
| Other operating activities  | -                    | (194)             |
| Changes in operating assets and liabilities:                                      |                      |                   |
| Accounts receivable   | 3,793                | 8,992             |
| Income taxes  | 4,792                | 15,160            |
| Other assets  | 3,889                | 506               |
| Accounts payable  | 5,478                | 6                 |
| Accrued wages and benefits  | (5,179)              | (4,410)           |
| Workers' compensation claims reserve  | (1,588)              | 5,473             |
| Other current liabilities   | -                    | (38)              |
| Net cash provided by operating activities   | 27,732               | 34,212            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                      |                   |
| Capital expenditures  | (6,189)              | (3,859)           |
| Purchases of marketable securities  | (102,813)            | (11,243)          |
| Maturities of marketable securities   | 110,496              | 12,002            |
| Change in restricted cash and other assets  | (1,891)              | (7,431)           |
| Net cash used in investing activities   | (397)                | (10,531)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                      |                   |
| Purchase and retirement of common stock   | (76,749)             | -                 |
| Net proceeds from sale of stock through options and employee benefit plans        | 837                  | 1,335             |
| Excess tax benefits from stock-based compensation                                 | 418                  | 1,877             |
| Payments on debt  | (188)                | (193)             |
| Net cash (used in) provided by financing activities                               | (75,682)             | 3,019             |
| Effect of exchange rates on cash  | 199                  | 202               |
| Net change in cash and cash equivalents   | (48,148)             | 26,902            |
| CASH AND CASH EQUIVALENTS, beginning of period                                    | 107,944              | 82,155            |
| CASH AND CASH EQUIVALENTS, end of period  | \$ 59,796            | \$ 109,057        |

See accompanying notes to consolidated financial statements



**Notes to Consolidated Financial Statements**

**NOTE 1: ACCOUNTING PRINCIPLES AND PRACTICES**

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 thirteen week period ended March 30, 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, workers compensation expenses and transportation.

***Stock-based compensation***

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 March 30, 2007 was \$2.4 million, before income taxes, compared to total stock-based compensation expense for the thirteen weeks ended March 31, 2006 of \$2.5 million, before income taxes.

See further discussion of stock-based compensation in Note 10.

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**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 12 for further discussion.

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 are currently evaluating the impact of SFAS No. 157 and whether our 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: MARKETABLE SECURITIES**

Management determines the appropriate classification, pursuant to SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, of our investments in debt securities ( Marketable Securities ) at the time of purchase and re-evaluates such determination at each balance sheet date. Marketable Securities consist of revenue bonds and other municipal obligations, which usually have maturities or reset dates of one year or less. At March 30, 2007 and December 29, 2006, those securities were classified as available-for-sale and stated at fair value, with the unrealized holding gains and losses reported in the shareholders' equity section of our Consolidated Balance Sheets. There were no material unrealized holding gains or losses at March 30, 2007 or December 29, 2006. The specific identification method is used for computing realized gains and losses on the sale of available-for-sale securities. For the thirteen weeks ended March 30, 2007 and March 31, 2006, there were no material realized gains or losses on sales of available-for-sale securities. These marketable securities are available to fund current operations, if necessary.

**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. These assets may be released as workers' compensation claims are paid or when letters of credit are released.

The following is a summary of restricted cash and other assets:

|   | <b>March 30,<br/>2007</b> | <b>December 29,<br/>2006</b> |
|---|---------------------------|------------------------------|
| Workers Assurance Program committed collateral(1) | \$ 140.4                  | \$ 138.7                     |
| Cash collateralizing surety bonds                 | 3.9                       | 3.8                          |
| Workers Assurance Program- uncommitted cash(1)    | 0.4                       | 0.5                          |
| Other   | 0.9                       | 0.7                          |
| <b>Total Restricted Cash and Other Assets</b>     | <b>\$ 145.6</b>           | <b>\$ 143.7</b>              |

(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. 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. Uncommitted cash represents cash available for funding future commitments.

#### NOTE 4: RECEIVABLES FROM INSURANCE COMPANIES

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 March 30, 2007 and December 29, 2006 is \$5.0 million and \$2.5 million, respectively. Total discounted receivables from insurance companies, net of related valuation allowance, as of March 30, 2007 and December 29, 2006 are \$14.8 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 March 30, 2007 is a receivable from our insurance company of \$1.8 million in connection with certain litigation.

#### NOTE 5: INTANGIBLE ASSETS

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):

|  | March 30,<br>2007 | December 29,<br>2006 |
|--|-------------------|----------------------|
| Amortizable intangible assets:         |                   |                      |
| Trade name/trademarks                  | \$ 400            | \$ 400               |
| Customer relationships                 | 11,600            | 11,600               |
| Non-compete agreements                 | 1,600             | 1,600                |
|  | 13,600            | 13,600               |
| Less accumulated amortization          | 6,172             | 5,726                |
| Total amortized intangible assets, net | \$ 7,428          | \$ 7,874             |
| Unamortizable intangible assets:       |                   |                      |
| Trade name/trademarks                  | \$ 6,500          | \$ 6,500             |
| Total unamortizable intangible assets  | \$ 6,500          | \$ 6,500             |



Intangible assets recorded as a result of the CLP Resources acquisition in May 2005 and the Spartan Staffing acquisition in April 2004 totaled \$20.1 million. Intangible assets are amortized using the straight line method over their estimated useful lives. Unamortized intangible assets of \$7.4 million consist entirely of Customer relationships resulting from the CLP acquisition with an estimated useful life of 6.5 years. The majority of our trade name/trademarks do not have definite lives and, accordingly, are not amortized. All other intangible assets are fully amortized. Amortization expense of our amortizable intangible assets was \$0.4 million and \$0.8 million for the thirteen weeks ended March 30, 2007 and March 31, 2006, respectively.

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 | \$ | 1,222 |
| 2008              |    | 1,585 |
| 2009              |    | 1,585 |
| 2010              |    | 1,585 |
| 2011              |    | 1,451 |
| Thereafter        |    | -     |
|                   | \$ | 7,428 |

Goodwill totaled \$37.4 million at March 30, 2007 and December 29, 2006. Goodwill recorded as a result of the CLP Resources acquisition in 2005 totaled \$31.0 million. Goodwill recorded as a result of the Spartan Staffing acquisition in 2004 totaled \$6.4 million.

#### NOTE 6: WORKERS COMPENSATION INSURANCE AND RESERVES

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 2006 through June 2007. 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 March 30, 2007, our reserves are discounted at rates ranging from 4.31% to 6.00%. Included in the accompanying Consolidated Balance Sheets as of March 30, 2007 and December 29, 2006 are discounted workers compensation claims reserves in the amounts of \$187.8 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 and any changes in the valuation allowance related to receivables from Troubled Insurance Companies as described in Note 4. Workers compensation expense totaling \$14.4 million and \$18.4 million was recorded for the thirteen weeks ended March 30, 2007 and March 31, 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 0.8 million during the thirteen weeks ended March 30, 2007 and 0.3 million during the thirteen weeks ended March 31, 2006.

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

|  | <b>Thirteen Weeks Ended</b> |                           |
|--|-----------------------------|---------------------------|
|  | <b>March 30,<br/>2007</b>   | <b>March 31,<br/>2006</b> |
| Net income   | \$ 10,348                   | \$ 11,466                 |
| Weighted average number of common shares used in basic net income per common share   | 49,076                      | 53,680                    |
| Dilutive effect of outstanding stock options and non-vested restricted stock         | 266                         | 767                       |
| Weighted average number of common shares used in diluted net income per common share | 49,342                      | 54,447                    |
| Net income per common share:   |                             |                           |
| Basic  | \$ 0.21                     | \$ 0.21                   |
| Diluted  | \$ 0.21                     | \$ 0.21                   |

The decrease in weighted average shares year over year is primarily due to our extensive share repurchase program. See Note 11 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 March 30, 2007, our margin was 0.50% and our unused capacity fee was 0.15%. At March 30, 2007, we had \$45.5 million of letters of credit issued against that borrowing capacity leaving us with \$34.5 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 March 30, 2007. The letters of credit issued related to our Workers Assurance Program bear fluctuating annual fees, which



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were approximately 0.46% of the principal amount of the letters of credit outstanding as of March 30, 2007. The surety bonds bear annual fees based on a percentage of the bond, which is determined by each independent surety carrier but does not exceed 2.0% of the bond amount, subject to a minimum charge.

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At March 30, 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):

|  |           | <b>Workers Compensation Commitments as of:</b> |                              |
|--|-----------|--|------------------------------|
|  |           | <b>March 30,<br/>2007</b>                      | <b>December 29,<br/>2006</b> |
| Workers Assurance Program - committed collateral | \$        | 140.4  | \$ 138.7                     |
| Letters of credit                                |           | 45.5   | 45.5                         |
| Surety bonds (1)                                 |           | 17.6   | 17.6                         |
| Other cash backed instruments                    |           | 0.6  | 0.6                          |
| <b>Total Collateral Commitments</b>              | <b>\$</b> | <b>204.1</b>                                   | <b>\$ 202.4</b>              |

(1) We had \$3.9 million and \$3.8 million of restricted cash collateralizing our surety bonds at March 30, 2007 and December 29, 2006, respectively.

### ***Capital Leases***

The following is a summary of property held under non-cancelable capital leases and reported in property and equipment in the Consolidated Balance Sheets (in thousands):

|  | <b>March 30,<br/>2007</b> | <b>December 29,<br/>2006</b> |
|--|---------------------------|------------------------------|
| Computers and software                         | \$ 2,699                  | \$ 2,945                     |
| Cash dispensing machines                       |                           | 922                          |
| Furniture and equipment                        | 159                       | 206                          |
|  | 2,858                     | 4,073                        |
| Less accumulated depreciation and amortization | 1,573                     | 2,217                        |
|  | <b>\$ 1,285</b>           | <b>\$ 1,856</b>              |

Future minimum lease payments under these non-cancelable capital leases as of March 30, 2007 are \$0.8 million for the remainder of 2007 and \$0.2 million for 2008. There are currently no minimum lease payments under non-cancelable capital leases after 2008.

Our capital lease obligations are reported in other liabilities in the Consolidated Balance Sheets. The weighted average interest rate on capitalized leases is approximately 3.0% and the lease terms range from 36 to 60 months.

### ***Operating Leases***

We have contractual commitments in the form of operating leases related to branch offices, vehicles and equipment. Future non-cancelable minimum lease payments under our operating lease commitments as of March 30, 2007 for each of the next five years and thereafter are \$4.7 million for the remainder of 2007; \$5.1 million for 2008; \$3.8 million for 2009; \$2.9 million for 2010; \$2.1 million for 2011 and \$3.1 million thereafter.

The majority of operating leases pertaining to our branch offices provide for renewal options ranging from three to five years. Operating leases are generally renewed in the normal course of business, and most of the options are negotiated at the time of renewal. However, for the majority of our leases, both parties to the lease have the right to cancel the lease with 90 days notice. Accordingly, we have not included these leases in our disclosure of future minimum lease payments. Total branch office rent expense for the thirteen weeks ended March 30, 2007 and March 31, 2006 was approximately \$6.5 million and \$6.0 million, respectively.

### ***Legal Contingencies and Developments***

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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

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established reserves for our contingent legal and regulatory liabilities in the amount of \$6.5 million at March 30, 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.

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. The settlement is subject to Court approval. A hearing for court approval of the settlement terms will occur on May 2, 2007. All amounts related to settlement are accounted for in our established reserves for our contingent legal and regulatory liabilities.

On February 6, 2003, Scott Romer and Shawna Clark, both former Labor Ready employees, filed an action against us in California State Court, Los Angeles County. The plaintiffs allege that they were wrongfully exempted from overtime pay during their employment. They seek unquantified compensatory damages and certification of a class of similarly situated employees. On January 6, 2004, Patricia Huntley and Brandon McCall filed a complaint in intervention and have been included as plaintiffs in this lawsuit. This matter has been consolidated with the Recio matter below.

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. 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. This matter is currently in the discovery phase.

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. We have now sought independent review of this determination by filing a complaint with the Tax Court of New Jersey on December 15, 2006 and accordingly have not reserved for this matter as of March 30, 2007.

On December 15, 2006, Patricia Tennyson, a temporary employee, filed an action in California State Court, Ventura County, alleging that we failed to pay her all hours worked. The plaintiff further alleges that we engaged in unfair business practices in California. The plaintiff is seeking unspecified damages and certification of a class of similarly situated employees. On April 10, 2007, the court granted the plaintiff's motion to dismiss the matter without prejudice. This matter is resolved.

**NOTE 9: SUPPLEMENTAL CASH FLOW INFORMATION**

|   | <b>Thirteen Weeks Ended</b>   |                           |
|---|-------------------------------|---------------------------|
|   | <b>March 30,<br/>2007</b>     | <b>March 31,<br/>2006</b> |
|   | <b>(Amounts in Thousands)</b> |                           |
| <b>Non-cash investing and financing activities:</b> |                               |                           |
| Assets acquired with capital lease obligations      | \$                            | \$ 279                    |
| Asset retirement obligation                         | \$ 150                        | \$                        |
| Common stock bonus                                  | \$                            | \$ 339                    |



**NOTE 10: STOCK BASED COMPENSATION****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.

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. SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date based on the fair value of the award and recognized in our income statement over the requisite service period. See information regarding stock-based compensation recorded in our income statement in Note 1 to this Form 10-Q.

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

|  | Thirteen Weeks Ended |   |                   |   |
|--|----------------------|---|-------------------|---|
|  | March 30,<br>2007    |   | March 31,<br>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           |   |

As of March 30, 2007, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$3.2 million, which is expected to be recognized over a weighted average period of 2.0 years through 2011. Stock option activity follows (shares in thousands):

|                                      | Thirteen Weeks Ended<br>March 30, 2007 |  | (1)      |
|--------------------------------------|--|--|----------|
|                                      | Shares                                 |  | Price    |
| Outstanding at beginning of period   | 1,207                                  |  | \$ 13.93 |
| Granted                              | 247                                    |  | \$ 18.98 |
| Exercised                            | (133 )                                 |  | \$ 8.30  |
| Forfeited                            | (11 )                                  |  | \$ 10.72 |
| Expired                              | (11 )                                  |  | \$ 19.56 |
| Outstanding at the end of the period | 1,299                                  |  | \$ 15.48 |
| Exercisable at the end of the period | 730                                    |  | \$ 13.91 |

(1) Weighted average exercise price.

**Restricted Stock**

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 but 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):

|                                    | <b>Thirteen<br/>Weeks Ended<br/>March 30, 2007</b> |                      |
|------------------------------------|--|----------------------|
|                                    | <b>Shares</b>                                      | <b>(1)<br/>Price</b> |
| Nonvested at beginning of period   | 467  | \$ 19.89             |
| Granted                            | 227  | \$ 18.98             |
| Vested                             | (103 )   | \$ 18.08             |
| Forfeited                          | (11 )  | \$ 19.22             |
| Nonvested at the end of the period | 580  | \$ 19.85             |

(1) Weighted average market price on grant date.

As of March 30, 2007, total unrecognized stock-based compensation expense related to non-vested restricted stock was approximately \$10.2 million, which is expected to be recognized over a weighted average period of 1.9 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. 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 thirteen weeks ended March 30, 2007 and March 31, 2006, participants purchased 25,000 and 22,000 shares in the ESPP for cash proceeds of \$0.4 million and \$0.4 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 11: STOCK REPURCHASE**

On January 31, 2007, we announced that our Board of Directors authorized the future purchase of our common stock in either open market or private transactions at a total cost of up to \$75.0 million. During the thirteen weeks ended March 30, 2007, we purchased and retired 4.1 million shares of our common stock for \$76.7 million, including commissions, \$13.1 million of which was under a previous repurchase authorization and \$63.6 million of which was under the January 31, 2007 authorization. Share repurchases were funded through cash and cash equivalents. As of March 30, 2007, we had \$11.4 million authorized for future purchases. As of April 12, 2007 we had completed the January 2007 authorization for the purchase of common stock by purchasing an additional 0.6 million shares of our common stock for \$11.4 million. We did not acquire any shares of our common stock during the thirteen week period ended March 31, 2006.

On April 18, 2007, we announced that our Board of Directors authorized additional repurchases of our common stock in either open market or private transactions at a total cost of up to \$100.0 million.

#### **NOTE 12: INCOME TAXES**

We adopted the provisions of FIN 48 on December 30, 2006. Upon adoption of FIN 48, we recognized no material adjustment in the liability for unrecognized income tax benefits. At the adoption date of December 30, 2006, we had \$1.6 million of unrecognized tax benefits, all of which would impact our effective tax rate if recognized. As of March 30, 2007 there have not been any material changes in the amount of the liability for unrecognized tax benefits since the date of adoption.

We continue to recognize interest and penalties related to uncertain tax positions in Interest expense and Selling, general and administrative expenses, respectively. At the adoption date amounts for accrued interest and penalties were not material.





The tax years 2002-2006 remain open to examination by the major taxing jurisdictions to which we are subject.

**NOTE 13: SUBSEQUENT EVENT**

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 approximately \$25.5 million in cash. Founded in 1993, SSC is a skilled construction trades staffing provider with 21 locations in Florida, Texas, Arizona, California, Colorado, and North Carolina.

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**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 and in the Risk Factors included in this Form 10-Q. 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 temporary employees for manual labor, light industrial, and skilled construction trades, operating under the brand names of Labor Ready, Labour Ready, Workforce, Spartan Staffing, and CLP Resources. 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 March 30, 2007 we had 913 branches located in all 50 of the United States, Canada, Puerto Rico and the United Kingdom. We believe our ability to provide a large number of temporary employees on short notice, usually the same day as requested, provides us with a competitive advantage.

Revenue for the thirteen weeks ended March 30, 2007 of \$290.0 million decreased 2.3% compared to \$297.1 million for the same period in 2006. The decline in revenue resulted in a 9.8% decrease in net income for the thirteen weeks ended March 30, 2007 of \$10.3 million or \$0.21 per diluted share, compared to net income of \$11.5 million or \$0.21 per diluted share for the thirteen weeks ended March 31, 2006. The change in revenue was primarily due to a decrease in same branch revenue as a result of a slowing residential construction market. To a lesser extent, we experienced less growth from new branches and an increase in the loss of revenue from closed branches. We have scaled back the number of new branch openings and have closed underperforming branches in response to the slower economic conditions we have experienced during the last half of 2006 and into 2007.

Gross margin improved to 32.0% for the thirteen weeks ended March 30, 2007 compared to 31.3% for the same period last year. The increase in gross margin was primarily due to a decrease in workers' compensation expense offset by increased wage and pricing pressure. The improvement in workers' compensation expense is related to improvements in accident prevention and risk management. Wage pressure to our temporary workers was heavily driven by numerous minimum wage increases which have not been fully passed through in the bill rates we charge our customers. Selling, general and administrative (SG&A) expenses as a percentage of revenue were 26.7% of revenue for the thirteen weeks ended March 30, 2007 compared to 25.0% for the same period in 2006. The increase can be attributed to less revenue than in the same quarter a year ago and a change in the mix of branches operating in each of our brands.

Net interest and other income as a percentage of sales improved slightly to 1.1% of revenue for the thirteen weeks ended March 30, 2007 compared to 0.9% for the same period in 2006. The increase can be attributed to higher yields on invested cash.

On January 31, 2007, we announced that our Board of Directors authorized the future purchase of our common stock in either open market or private transactions at a total cost of up to \$75.0 million. During the thirteen weeks ended March 30, 2007, we purchased \$76.7 million of our common stock, including commissions, \$13.1 million of which was under a previous repurchase authorization and \$63.6 million of which was under the January 31, 2007 authorization. As of March 30, 2007, we had \$11.4 million authorized for future purchases under the January 31, 2007 authorization. As of April 12, 2007 we had completed the authorization for the purchase of common stock by purchasing an additional 0.6 million shares of our common stock for \$11.4 million. On April 18, 2007, we announced that our Board of Directors authorized additional repurchases of our common stock in either open market or private transactions at a total cost of up to \$100.0 million.

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**Results of Operations**
**Thirteen Weeks Ended March 30, 2007 Compared to Thirteen Weeks Ended March 31, 2006**

The following table compares the operating results for the thirteen weeks ended March 30, 2007 and March 31, 2006 (in thousands):

|  | <b>Thirteen Weeks Ended</b> |                           |                           |
|--|-----------------------------|---------------------------|---------------------------|
|  | <b>March 30,<br/>2007</b>   | <b>March 31,<br/>2006</b> | <b>Percent<br/>Change</b> |
| Revenue from services                        | \$ 290,237                  | \$ 297,067                | (2.3 %)                   |
| Cost of services                             | 197,446                     | 204,150                   | (3.3 %)                   |
| Gross profit                                 | 92,791                      | 92,917                    | (0.1 %)                   |
| Selling, general and administrative expenses | 77,376                      | 74,224                    | 4.2 %)                    |
| Depreciation and amortization                | 2,401                       | 2,796                     | (14.1 %)                  |
| Interest expense                             | (262 )                      | (263 )                    | (0.4 %)                   |
| Interest and other income                    | 3,544                       | 3,009                     | 17.8 %)                   |
| Income before tax expense                    | 16,296                      | 18,643                    | (12.6 %)                  |
| Net income                                   | \$ 10,348                   | \$ 11,466                 | (9.8 %)                   |

**Branch Offices and Revenue from Services.** The number of branch offices increased to 913 at March 30, 2007 from 908 at March 31, 2006, a net increase of five branch offices. Revenue for the thirteen weeks ended March 30, 2007 decreased 2.3% compared to the same quarter a year ago. The change in revenue was made up of the following four components: (a) a (3.1%) decrease in same store branch revenue, defined as those branches opened one year or longer, (b) a (1.2%) decline in revenue related to branches closed over the past twelve months, (c) a 1.6% increase in revenue from new branches opened less than one year and (d) a 0.4% increase from other miscellaneous factors. The change in revenue was primarily due to a decrease in same branch revenue as a result of a slowing residential construction market. To a lesser extent, we experienced less growth from new branches and an increase in the loss of revenue from closed branches. We have scaled back the number of new branch openings and have closed underperforming branches in response to the slower economic conditions we have experienced during the last half of 2006 and into 2007.

**Cost of Services and Gross Profit.** Cost of services was 68.0% of revenue for the thirteen weeks ended March 30, 2007 compared to 68.7% for the thirteen weeks ended March 31, 2006. Workers' compensation costs for the thirteen weeks ended March 30, 2007 were approximately 5.0% of revenue compared to 6.2% in the thirteen weeks ended March 31, 2006. The reduction to our workers' compensation costs is the product of our safety and risk management programs that continue to reduce the frequency of accidents. The decrease in workers' compensation costs was partially offset by an increase in wages paid to temporary workers. Seventeen U.S. states and four Canadian provinces increased minimum wages during the thirteen weeks ended March 30, 2007 which have not been fully passed through in the bill rates we charge our customers. Our average pay rate mix increased 4.4% and bill rate mix increased 3.5%.

**Selling, General, and Administrative Expenses.** Selling, general and administrative (SG&A) expenses as a percentage of revenue were 26.7% for the thirteen weeks ended March 30, 2007 compared to 25.0% for the thirteen weeks ended March 31, 2006. This increase was primarily due to the decline in revenue and also a change in the mix of branches operating in each of our brands. During the thirteen weeks ended March 30, 2007 we had a larger mixture of CLP and Spartan Staffing branches compared to the same quarter a year ago, which have a higher cost structure than the Labor Ready brand.

**Depreciation and Amortization Expenses.** Depreciation and amortization expenses decreased to \$2.4 million for the thirteen weeks ended March 30, 2007 from \$2.8 million for the thirteen weeks ended March 31, 2006. The decrease in the current year is the result of certain intangible assets becoming fully amortized during 2006.

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**Interest and Other Income.** Interest and other income was \$3.5 million for the thirteen weeks ended March 30, 2007 compared to \$3.0 million for the thirteen weeks ended March 31, 2006. The change in interest and other income is attributable to higher yields on our restricted cash balances.

**Income Tax** Our effective tax rate on earnings for the thirteen weeks ended March 30, 2007 was 36.5%, compared to 38.5% for the thirteen weeks ended March 31, 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 extension of the Work Opportunity Tax Credit at the end of 2006.

We have a net deferred tax asset of approximately \$9.0 million at March 30, 2007 resulting primarily from workers' compensation reserves, contingent liabilities and allowance for doubtful accounts. We assessed our past earnings history and trends, projected sales, expiration dates of loss carry forwards, and our ability to implement tax planning strategies which are designed to accelerate or increase taxable income.

#### **Summary of Critical Accounting Policies**

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to workers' compensation claims, bad debts, goodwill and intangible assets, contingencies and litigation and income taxes. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies, among others, reflect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

**Workers' Compensation Reserves.** 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. These estimates are impacted by items that have been reported but not settled and items that have been incurred but not reported. This reserve, which reflects potential liabilities to be paid in future periods based on estimated payment patterns, is discounted to its estimated net present value using discount rates based on average returns of risk-free U.S. Treasury instruments with maturities comparable to the average lives of our workers' compensation claims. We evaluate the reserve regularly throughout the year and make adjustments accordingly. If the actual cost of such claims and related expenses exceeds the amounts estimated, additional reserves may be required.

**Allowance for Doubtful Accounts.** **We establish an allowance for doubtful accounts for estimated losses resulting from the failure of our customers to make required payments. We evaluate this allowance regularly throughout the year and make adjustments as needed. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make**

Allowance for Doubtful Accounts. We establish an allowance for doubtful accounts for estimated losses resulting from

## **payments, additional allowances may be required.**

*Goodwill and Intangible Assets.* As a result of our acquisitions, we have recorded goodwill and various intangible assets at their estimated fair values. The estimated fair values of the acquired indefinite-lived intangible assets are based on our expectations regarding future operating results and cash flows. The purchase price in excess of the fair value of the acquired tangible and intangible assets is classified as goodwill and is tested for impairment in the fourth quarter of each fiscal year and whenever events or circumstances indicate that an impairment may have occurred. Fair value for purposes of our impairment test is determined based on discounted cash flows, market multiples or appraised values as appropriate. Such analysis requires the use of certain future market assumptions and discount factors, which are subjective in nature. Estimated values can be affected by many factors beyond the company's control such as business and economic trends and government regulation. Management believes that the assumptions used to determine fair value are appropriate and reasonable. However, changes in circumstances or conditions affecting these assumptions could have a significant impact on the fair value determination, which could then result in a material impairment charge to the company's results of operations.

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*Reserves for Contingent Legal and Regulatory Liabilities.* **We have established reserves for contingent legal and regulatory liabilities. We record a liability when our management judges that it is probable that a legal claim will result in an adverse outcome and the amount of liability can be estimated. We evaluate this reserve regularly throughout the year and make adjustments as needed. If the actual outcome of these matters is different than expected, an adjustment is charged or credited to expense in the period the outcome occurs or the period in which the estimate changes.**

*Income Taxes and Related Valuation Allowances.* We account for income taxes by recording taxes payable or refundable for the current year and deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns. As required under Statement of Financial Accounting Standard No. 109, *Accounting for Income Taxes* ( SFAS No. 109 ), and related interpretations, we measure these expected future tax consequences based upon the provisions of tax law as currently enacted; the effects of future changes in tax laws are not anticipated. Future tax law changes, such as a change in the corporate tax rate, could have a material impact on our financial condition or results of operations.

#### **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 \$27.7 million for the thirteen weeks ended March 30, 2007 and was due primarily to our net income and cash provided by operating assets and liabilities.

Net income totaled \$10.3 million for the thirteen weeks ended March 30, 2007. Cash provided by operating assets and liabilities was primarily due to increases in accounts payable and income taxes payable and decreases in other assets and accounts receivable, offset by decreases in accrued wages and benefits. These changes were primarily the result of timing of payments and receipts.

Net cash provided by operating activities was lower for the thirteen weeks ended March 30, 2007 than the comparable prior year period. The decrease was largely a result of change in income taxes payable in the prior year due mostly to the timing and method of making estimated income tax payments.

#### *Cash Flows from Investing Activities*

Net cash used in investing activities was \$0.4 million for the thirteen weeks ended March 30, 2007. Cash used in investing activities included capital expenditures due to technology projects. These outflows were offset by cash provided by investing activities for net maturities of marketable securities.

Reserves for Contingent Legal and Regulatory Liabilities. We have established reserves for contingent legal and re



*Cash Flows from Financing Activities*

Net cash used in financing activities was \$75.7 million for the thirteen weeks ended March 30, 2007. During the thirteen weeks ended March 30, 2007, we purchased and retired 4.1 million shares of our common stock for \$76.7 million, including commissions, \$13.1 million of which was under a previous repurchase authorization and \$63.6 million of which was under a January 31, 2007 authorization. Share repurchases were funded through cash and cash equivalents. As of March 30, 2007, we had \$11.4 million authorized for future purchases. As of April 12, 2007 we had completed the January 31, 2007 authorization for the purchase of common stock by purchasing an additional 0.6 million shares of our common stock for \$11.4 million. On April 18, 2007, we announced that our Board of Directors authorized additional repurchases of our common stock in either open market or private transactions at a total cost of up to \$100.0 million.

*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 March 30, 2007, our margin was 0.50% and our unused capacity fee was 0.15%. At March 30, 2007, we had \$45.5 million of letters of credit issued against that borrowing capacity leaving us with \$34.5 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 March 30, 2007 we had restricted cash in our Workers Assurance Program totaling \$140.8 million. Of this cash, \$140.4 million was committed to insurance carriers leaving \$0.4 million available for future needs.

We believe that cash provided from 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 2006 through June 2007. 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. Our 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.

At March 30, 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):

|  | <b>Workers Compensation Commitments as of:</b> |                              |
|--|--|------------------------------|
|  | <b>March 30,<br/>2007</b>                      | <b>December 29,<br/>2006</b> |
| Workers Assurance Program - committed collateral (1) | \$ 140.4                                       | \$ 138.7                     |
| Letters of credit                                    | 45.5   | 45.5                         |
| Surety bonds (2)                                     | 17.6   | 17.6                         |
| Other cash backed instruments                        | 0.6  | 0.6                          |
| <b>Total Collateral Commitments</b>                  | <b>\$ 204.1</b>                                | <b>\$ 202.4</b>              |

(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 \$3.9 million and \$3.8 million of restricted cash collateralizing our surety bonds at March 30, 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 does 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.

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 0.45% as of March 30, 2007.



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

|   | <b>March 30,<br/>2007</b> | <b>December 29,<br/>2006</b> |
|---|---------------------------|------------------------------|
| Ending workers' compensation reserve:   | \$ 187.8                  | \$ 189.4                     |
| a) Discount on reserves   | 41.6                      | 41.3                         |
| b) Timing of collateral release with prior providers                            | 14.5                      | 13.0                         |
| c) Collateral posted with current provider in comparison to obligation incurred | (17.0)                    | (19.4)                       |
| d) Reserves for claims above our deductible ( excess claims ), net of discount  | (22.8)                    | (21.9)                       |
| <b>Total Collateral Commitments</b>   | <b>\$ 204.1</b>           | <b>\$ 202.4</b>              |

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 in comparison to the estimated balance of unpaid claims; 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 regularly reviews and evaluates the adequacy of reserves for prior periods. 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 March 30, 2007 our reserves are discounted at rates ranging from 4.31% to 6.00%.

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, (i) inflation of medical and indemnity costs at a rate higher than originally anticipated, (ii) regulatory and legislative developments that have increased benefits and settlement requirements in several states, (iii) a different mix of business than previously anticipated, (iv) the impact of safety initiatives implemented, and (v) 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.

|   | <b>Thirteen Weeks Ended</b> |                           |
|---|-----------------------------|---------------------------|
|   | <b>March 30,<br/>2007</b>   | <b>March 31,<br/>2006</b> |
| Beginning balance                                   | \$ 189,435                  | \$ 167,859                |
| <b>Self-insurance reserve expense</b>               |                             |                           |
| Expenses related to current year (net of discount). | 13,280                      | 16,050                    |
| Change related to prior years                       | (7,288 )                    | (3,296 )                  |
| Total   | 5,992                       | 12,754                    |
| Amortization of prior years discount                | 2,288                       | 1,362                     |
| <b>Payments</b>                                     |                             |                           |
| Payments related to current year claims             | (558 )                      | (526 )                    |
| Payments related to claims from prior years         | (10,083 )                   | (9,423 )                  |
| Total   | (10,641 )                   | (9,949 )                  |
| Net change in excess claims reserve                 | 773                         | 1,306                     |
| Ending balance                                      | 187,847                     | 173,332                   |
| Less current portion                                | 49,669                      | 45,377                    |
| Long-term portion                                   | \$ 138,178                  | \$ 127,955                |

**Other**

Included in cash and cash equivalents at March 30, 2007 and December 29, 2006 is cash held within branch CDMs for payment of temporary payrolls in the amount of \$13.4 million and \$19.6 million, respectively.

Our capital expenditures were \$6.2 million and \$4.1 million for the thirteen weeks ended March 30, 2007 and March 31, 2006, respectively. We anticipate total capital expenditures for 2007 to be in the range of \$12 million to \$15 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 thirteen week period ended March 30, 2007.

The following table provides a summary of our contractual obligations as of March 30, 2007 (in thousands):

| Contractual Obligations                   | Payments Due By Period |                  |                         |                         |                      |
|---|------------------------|------------------|-------------------------|-------------------------|----------------------|
|   | Total                  | 2007             | 2008<br>through<br>2009 | 2010<br>through<br>2011 | 2012<br>and<br>later |
| Capital lease obligations (1)             | \$ 971                 | \$ 774           | \$ 197                  | \$                      | \$                   |
| Operating leases (2)                      | 21,670                 | 4,653            | 8,868                   | 4,988                   | 3,161                |
| Purchase obligations (3)                  | 4,814                  | 3,123            | 1,691                   |                         |                      |
| Other long-term obligations (4)           | 8,857                  | 2,544            | 5,823                   | 490                     |                      |
| Other cash obligations (5)                | 7,337                  | 7,337            |                         |                         |                      |
| <b>Total Contractual Cash Obligations</b> | <b>\$ 43,649</b>       | <b>\$ 18,431</b> | <b>\$ 16,579</b>        | <b>\$ 5,478</b>         | <b>\$ 3,161</b>      |

- (1) Primarily consists of payments on computer equipment and technology commitments.
- (2) Excludes all payments related to branch leases cancelable by either party to the lease within 90 days.
- (3) Binding purchase orders for goods or services outstanding at March 30, 2007.
- (4) Primarily consists of voice and data service contracts and licensing agreements.
- (5) Collateral obligations related to workers' compensation policy year ended July 1, 2007.

We are required by our insurance carriers and certain state workers' compensation programs to collateralize a portion of our workers' compensation obligation with cash. Our insurance carriers annually assess the amount of collateral they will require from us relative to our workers' compensation obligation. The amounts of cash available for future restriction are subject to our borrowing capacity under the Revolving Credit Facility and cash available at the time of the restriction. The following table provides a summary of our estimated collateral obligations and the collateral capacity available to us as of March 30, 2007 (in thousands):

|  |            |
|--|------------|
| Revolving Credit Facility-Capacity           | \$ 80,000  |
| Revolving Credit Facility-Committed          | (45,500 )  |
| Revolving Credit Facility-Available Capacity | 34,500     |
| Cash and cash equivalents                    | 59,796     |
| Marketable securities                        | 83,822     |
| Total Capacity                               | 178,118    |
| Estimated Collateral Restriction for 2007    | (29,600 )  |
| Remaining Collateral Capacity                | \$ 148,518 |

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates, each of which could adversely affect the value of our investments. We do not currently use derivative financial instruments. As of March 30, 2007, our purchased investments included in cash and cash equivalents had maturities of less than 90 days. Therefore, an increase in interest rates immediately and uniformly by 10% from our 2006 year end levels would not have a material effect upon our cash and cash equivalent balances, operating results or cash flows.

As of March 30, 2007, our marketable securities consist of revenue bonds and other municipal obligations, which usually have maturities or reset dates of one year or less. Therefore, an increase in interest rates immediately and uniformly by 10% from our 2006 year end levels would not have a material effect upon our marketable securities balances, operating results or cash flows.

We have a certain amount of assets and liabilities denominated in certain foreign currencies related to our international operations. We have not hedged our foreign currency translation risk and we have the ability to hold our foreign-currency denominated assets indefinitely and do not expect that a sudden or significant change in foreign exchange rates will have a material impact on future operating results or cash flows.

**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 (as defined in Securities Exchange Act Rule 13a-15(e)). Based on this evaluation, our CEO and our CFO concluded that, as of March 30, 2007, our disclosure controls and procedures are effective.

*Changes in Internal Control Over Financial Reporting.* During the thirteen weeks ended March 30, 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.

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**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**

*Investing in our securities involves a high degree of risk. The following risk factors, issues and uncertainties should be considered in evaluating our future prospects. In particular, keep these risk factors in mind when you read forward-looking statements elsewhere in this report. Forward-looking statements relate to our expectations for future events and time periods. 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. Any of the following risks could harm our business, operating results or financial condition and could result in a complete loss of your investment. Additional risks and uncertainties that are not yet identified or that we currently think are immaterial may also harm our business and financial condition in the future.*

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

***Competition for customers in our industry is intense, and if we are not able to effectively compete, our financial results could be harmed and the price of our securities could decline.***

The temporary services industry is highly competitive, with limited barriers to entry. Several very large full-service and specialized temporary labor companies, as well as small local operations, compete with us in the staffing industry. Competition in some markets is intense, particularly with regard to recruiting workers, and these competitive forces limit our ability to raise prices to our customers. For example, competitive forces have historically limited our ability to raise our prices to immediately and fully offset increased costs of doing business, including increased labor costs, costs for workers' compensation and state unemployment insurance. As a result of these forces, we have in the past faced pressure on our operating margins. Pressure on our margins remains intense, and we cannot assure you that it will not continue. If we are not able to effectively compete in our targeted markets, our operating margins and other financial results will be harmed and the price of our securities could decline.

***If we are not able to obtain insurance on commercially reasonable terms, our financial condition or results of operations could suffer.***

We maintain various types of insurance coverage to help offset the costs associated with certain risks to which we are exposed. We have previously experienced, and could again experience, changes in the insurance markets that result in significantly increased insurance costs and higher deductibles. For example, we are required to pay workers' compensation benefits for our temporary and permanent employees. Under our workers' compensation insurance program, we maintain per occurrence insurance, which covers claims for a particular event above a \$2.0 million deductible, and we do not maintain an aggregate stop-loss limit other than on a per-occurrence basis. While we have secured coverage with American International Group, Inc. (AIG) for occurrences during the period from July 2006 through June 2007, our insurance policies must be renewed annually, and we cannot guarantee that we will be able to successfully renew such policies for any period after June 2007. In the event we are not able to obtain workers' compensation insurance, or any of our other insurance coverages, on commercially reasonable terms, our ability to operate our business would be significantly impacted and our financial condition and results of operations could suffer.

We also maintain employment practice liability insurance (EPLI) for certain types of claims that may arise out of the course of employment. We currently maintain a policy with a \$1.0 million deductible for single-party claims and a \$2.5 million deductible for multiple-party claims with a maximum aggregate coverage of \$10.0 million per claim and per policy year which is applicable to the coverage period of July 2006 through June 2007. The EPLI market has historically experienced increased losses creating increases in insurance premiums, increases in deductible limits, and decreases in overall coverage. In the event we are unable to retain EPLI coverage on commercially reasonable terms, our financial condition and results of operations could suffer.

***We expect that the amount of collateral that we are required to post to support our workers' compensation obligations will increase, which will reduce the capital we have available to grow and support our operations.***

We are required to maintain commitments such as cash and cash-backed instruments, irrevocable letters of credit, and/or surety bonds to secure repayment to our insurance companies (or in some instances, the state) of the deductible portion of all open workers' compensation claims. We pledge cash or other assets in order to secure these commitments and there are a number of factors that cause the size of our collateral commitments to grow over time. First, as our business grows so does our workers' compensation reserve and the collateral needed to support it.



Second, we sometimes face difficulties in recovering our collateral from insurers, particularly when those insurers are in financial distress, and we cannot guarantee that our collateral for past claims

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will be released in a timely manner as we pay down claims. As a result, we expect that the amount of collateral required to secure our commitments to our insurance carriers will continue to increase. We believe that our current sources of liquidity will satisfy our immediate needs for these obligations; however, our currently available sources of capital for these commitments are limited and we could be required to seek additional sources of capital in the future. These additional sources of financing may not be available on commercially reasonable terms. Even if they are available, these financings could result in dilution of earnings to our existing shareholders.

***Our reserves for workers compensation claims and other liabilities and our allowance for doubtful accounts may be inadequate, and we may incur additional charges if the actual amounts exceed the estimated amounts.***

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. These estimates are impacted by items that have been reported but not settled and items that have been incurred but not reported. This reserve, which reflects potential liabilities to be paid in future periods based on estimated payment patterns, is discounted to its 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. We evaluate the reserve regularly throughout the year and make adjustments accordingly. If the actual costs of such claims and related expenses exceed the amounts estimated, or if the discount rates represent an inflated estimate of our return on capital over time, actual losses for these claims may exceed reserves and/or additional reserves may be required. We also establish an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. We have also established reserves for contingent legal and regulatory liabilities, based on management's estimates and judgments of the scope and likelihood of these liabilities. We believe our judgments and estimates are adequate; however if the actual outcome of these matters is less favorable than expected, an adjustment would be charged to expense in the period in which the outcome occurs or the period in which our estimate changes.

***Two insurance companies with which we have previously done business are in liquidation, and one other has been relieved of its insurance obligations to us. If our insurers do not fulfill their obligations, we could experience significant losses.***

Prior to our current policies with AIG, we purchased annual insurance policies in connection with our workers compensation obligations from three primary carriers. Prior to 2001, Legion Insurance Company (Legion) and Reliance Insurance Company (Reliance) provided coverage to us. Legion and Reliance are in liquidation and have failed to pay a number of covered claims that exceed our deductible limits ( excess claims ). 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. As a result, we have concluded that recovery is unlikely on a portion of these excess claims. To the extent we experience additional claims that exceed our deductible limits and our insurers do not satisfy their coverage obligations, we may be forced to satisfy some or all of those claims directly; this in turn could harm our financial condition or results of operations.

Our workers compensation reserves include not only estimated expenses for claims within our deductible layer but also estimated expenses related to claims in excess of the deductible. We record a receivable for the insurance coverage on excess claims. We have also recorded a valuation allowance against the insurance receivables from Legion and Reliance to reflect our best estimates of amounts we may not realize as a result of the liquidations of those insurers. The outcome of those liquidations is inherently uncertain; we may realize significantly less than currently estimated, in which case an adjustment would be charged to expense in the period in which the outcome occurs or the period in which our estimate changes.

Kemper Insurance Company (Kemper) provided coverage for occurrences commencing in 2001 through June 30, 2003. In December 2004, we executed a Novation agreement pursuant to which we relinquished insurance coverage and assumed all further liability for all claims originating in the Kemper policy years. These claims are reserved for in the consolidated financial statements. Although we believe our judgments and estimates are adequate, we cannot assure you that claims originating in the Kemper policy years will not experience unexpected adverse developments.

***Our operations expose us to the risk of litigation which could lead to significant potential liability and costs that could harm our business, financial condition or results of operations.***

We are in the business of employing people and placing them in the workplaces of other businesses. As a result, we are subject to a large number of federal and state laws and regulations relating to employment. This creates a risk of potential claims of discrimination and harassment, violations of health and safety and wage and hour laws, criminal activity, personal injury and other claims. We are also subject to other types of claims in the ordinary course of our business. Some or all of these claims may give rise to litigation, which could be time-consuming for our management team, costly and harmful to our business.



In addition, we are exposed to class action litigation. The costs of defense and the risk of loss in connection with class action suits are greater than in single-party claims. Due to the costs of defending against such litigation, any judgments that may be awarded against us and the loss of significant management time devoted to such litigation, we cannot assure you that such litigation will not disrupt our business or impact our financial results.

With regard to employment claims, we currently maintain a policy with a \$1.0 million deductible for single-party claims and a \$2.5 million deductible for multiple-party claims with a maximum aggregate coverage of \$10.0 million per claim and per policy year which is applicable to the coverage period of July 2006 through June 2007. With regard to general liability claims, we currently maintain a policy with a \$1.0 million self-insured retention for all claims with a maximum coverage of \$500,000 per claim and a \$5.0 million aggregate per policy year which is applicable to the coverage period of July 2006 through June 2007.

We cannot assure you that our insurance will be sufficient in amount or scope to cover any of these types of liabilities or that we will be able to continue to secure insurance coverage for such liabilities on terms that we find commercially reasonable.

***A significant portion of our revenue is derived from operations in a limited number of markets. Recessions in these markets have harmed and could continue to harm our operations.***

A significant portion of our revenue is derived from our operations in a limited number of states. Total revenue generated from operations in California, Texas and Florida, accounted for 38% of our overall revenue in 2006 and approximately 35% of our overall revenue in 2005 and 2004.

***Any significant economic downturn or increase in interest rates could result in our clients using fewer temporary employees, which could harm our business or cause the price of our securities to decline.***

Because demand for personnel services and recruitment services is sensitive to changes in the level of economic activity, our business may suffer during economic downturns. As economic activity slows down, companies tend to reduce their use of temporary employees and recruitment services before undertaking layoffs of their permanent employees, resulting in decreased demand for our personnel. In addition, as a result of our acquisition of CLP Resources, an increasing portion of our revenue is generated from work in the construction industry, so downturns in the construction industry may have a disproportionate impact on us. As interest rates rise, the amount of construction could decline, which will cause a reduction in the demand for the use of temporary employees in the construction industry. As a result, any significant economic downturn or increase in interest rates could harm our business, financial condition or results of operations, or cause the price of our securities to decline.

***Establishment and expansion of our international operations will burden our resources and may fail to generate a substantial increase in revenue.***

Our international branch operations expose us to certain risks. If we are not able to effectively manage those risks, our financial results could be harmed. As of March 30, 2007, we had 82 branches outside the United States in the United Kingdom and Canada. Risks not already discussed in connection with our domestic branch operations include: fluctuations in the value of foreign currencies and the additional expense and risks inherent in operations in geographically and culturally diverse locations.

***We are continually subject to the risk of new regulation, which could harm our business.***

In recent years, a number of bills have been introduced in Congress and various state legislatures any one of which, if enacted, would impose conditions which could harm our business. This proposed legislation, much of which is backed by labor unions, has included provisions such as a requirement that our temporary employees receive the same pay and benefits as our customers' permanent employees, a requirement that we spend a certain portion of our revenues on employee health care, a prohibition on fees charged in connection with our CDMs and a requirement that our customers provide workers' compensation insurance for our temporary employees. We take a very active role and incur expense in opposing proposed legislation adverse to our business and in informing policy makers as to the social and economic benefits of our business. However, we cannot guarantee that any of this legislation will not be enacted, in which event demand for our service may suffer.

Organized labor has, in the past and could again in the future, been active in sponsoring legislation which could significantly increase our costs of doing business or decrease the value of our services to our customers, either of which could harm our results of operations.

***The cost of compliance with government laws and regulations is significant and could harm our operating results.***

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We incur significant costs to comply with all applicable federal and state laws and regulations relating to employment, including occupational safety and health provisions, wage and hour requirements (including minimum wages), workers' compensation and unemployment insurance. We cannot assure you that we will be able to increase fees charged to our customers to offset increased costs relating to these laws and regulations. In addition, from time to time we are subject to audit by various state and governmental authorities to determine our compliance with a variety of these laws and regulations. We have in the past been

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found, and may in the future be found, to have violated such laws or regulations. We may, from time to time, incur fines and other losses or negative publicity with respect to any such violation. If we incur additional costs to comply with these laws and regulations or as a result of fines or other losses and we are not able to increase the rates we charge our customers to fully cover any such increase, our margins and operating results may be harmed.

***Our business depends extensively on recruiting and retaining qualified branch managers. If we are not able to attract a sufficient number of qualified branch managers, our future growth and financial performance may suffer.***

We rely heavily on the performance and productivity of our branch managers, who manage the operation of the branches, including recruitment and daily dispatch of temporary employees, marketing and providing quality customer service. We have historically experienced a high degree of turnover among our branch managers. As a result, we must continue to recruit a sufficient number of managers to staff new branches and to replace managers lost through attrition or termination. Our future growth and financial performance depend on our ability to hire, train and retain qualified managers from a limited pool of qualified candidates who frequently have no prior experience in the temporary employment industry.

***Our credit facility requires that we meet certain levels of financial performance. In the event we fail either to meet these requirements or have them waived, we may be subject to penalties and we could be forced to seek additional financing.***

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 requires that we comply with certain financial covenants. Among other things, these covenants require us to maintain certain leverage and coverage ratios. In the past we have negotiated amendments to these covenants to ensure our continued compliance with their restrictions. We cannot assure you that our lender would consent to such amendments on commercially reasonable terms in the future if we once again required such relief. In the event that we do not comply with the covenants and the lender does not waive such non-compliance, we will be in default of our credit agreement, which could subject us to penalty rates of interest and accelerate the maturity of the outstanding balances. Accordingly, in the event of a default under our credit facility, we could be required to seek additional sources of capital to satisfy our liquidity needs. These additional sources of financing may not be available on commercially reasonable terms. Even if they are available, these financings could result in dilution to our existing shareholders.

***Our acquisitions or acquisition efforts may not be successful, which may limit our growth or adversely affect our results of operations and financial condition.***

As part of our business strategy, we have made acquisitions of other temporary staffing businesses and we may continue to pursue such acquisitions in the future. Unsuccessful acquisition efforts may result in significant additional expenses that would not otherwise be incurred. Following an acquisition, we cannot assure you that we will be able to integrate the operations of the acquired business without significant difficulties, including unanticipated costs, difficulty in retaining customers, failure to retain key employees and the diversion of management attention. In addition, we may not realize the revenues and cost savings that we expect to achieve or that would justify the acquisition investment, and we may incur costs in excess of what we anticipate. These circumstances could adversely affect our results of operations or financial condition.

***We have significant working capital requirements.***

We require significant working capital in order to operate our business. We may experience periods of negative cash flow from operations and investment activities, especially during seasonal peaks in revenue experienced in the second and third quarter of the year. We invest significant cash into the opening and operations of new branches until they begin to generate revenue sufficient to cover their operating costs. We also pay our temporary employees on a daily basis and bill our customers on a weekly basis, and, on average, collect monthly. As a result, we must maintain cash reserves to pay our temporary employees prior to receiving payment from our customers. In addition, we are required to pledge certain short-term assets to secure letters of credit and to pledge other assets to collateralize our workers' compensation obligations. These collateral requirements may increase in future periods, which would decrease amounts available for working capital purposes. As a result of these factors, if our available cash balances and borrowing base under our existing credit facility do not grow commensurate with the growth in our working capital requirements, we could be required to explore alternative sources of financing to satisfy our liquidity needs, including the issuance of additional equity or debt securities. Any such issuances could result in dilution to existing shareholders.

***Our information and computer processing systems are critical to the operations of our business and any failure could cause significant problems.***

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Our information technology systems, located at our headquarters, are essential for data exchange and operational communications with branches throughout the country. Any interruption, impairment or loss of data integrity or malfunction of these systems could severely hamper our business and could require that we commit significant additional capital and management resources to rectify the problem.

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***The loss of any of our key personnel could harm our business.***

Our future financial performance will depend to a significant extent on our ability to motivate and retain key management personnel. Competition for qualified management personnel is intense and in the event we experience turnover in our key management positions, we cannot assure you that we will be able to recruit suitable replacements. We must also successfully assimilate new key management personnel into our organization to achieve our operating objectives. Even if we are successful, turnover in key management positions will temporarily harm our financial performance and results of operations until new management becomes familiar with our business. We do not maintain key person life insurance on any of our executive officers.

***Our business would suffer if we could not attract enough temporary employees or skilled trade workers.***

We compete with other temporary personnel companies to meet our customer needs and we must continually attract reliable temporary employees to fill positions. We have in the past experienced short-term worker shortages and we may continue to experience such shortages in the future. In addition, CLP Resources' business relies on the ability to attract skilled trade workers. If we are unable to find temporary employees or skilled trade workers to fulfill the needs of our customers over a long period of time, we could lose customers and our business could suffer.

***Determinations that we have misclassified the jobs performed by our temporary employees for workers' compensation insurance purposes in our monopolistic states, even if the misclassifications are inadvertent, could result in us owing penalties to government regulators and/or having to record additional expense.***

In four states (Washington, West Virginia, North Dakota, Wyoming), Canada and Puerto Rico, (our monopolistic states) we pay workers compensation insurance premiums directly to the government in amounts based in part on the classification of jobs performed by our employees. From time to time, we are subject to audits by various state regulators regarding our classifications of jobs performed by our employees. If it is determined that we have materially misclassified a significant number of our employees, we could be required to pay significant amounts of additional premium as well as penalties and interest.

***Labor unions have attempted to harm our business.***

Various labor unions and activist groups have attempted to disrupt our business. For example, these groups have backed legislation designed to adversely impact our business, coordinated legal actions directed at our activities and engaged in a public relations campaign to discredit members of our management team and influence our customers. We cannot assure you that these activities will not harm our business or the price of our securities.

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

**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 March 30, 2007.**

On January 31, 2007, we announced that our Board of Directors authorized the future purchase of our common stock in either open market or private transactions at a total cost of up to \$75.0 million. During the thirteen weeks ended March 30, 2007, we purchased \$76.7 million of our common stock, including commissions, \$13.1 million of which was under a previous repurchase authorization and \$63.6 million of which was under the January 31, 2007 authorization. As of March 30, 2007, we had \$11.4 million authorized for future purchases. As of April 12, 2007 we had completed the purchases of common stock remaining under the January 2007 authorization by purchasing an additional 0.6 million shares of our common stock for \$11.4 million. On April 18, 2007, we announced that our Board of Directors authorized additional repurchases of our common stock in either open market or private transactions at a total cost of up to \$100.0 million.

| 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 |
|--------------------------|--------------------------------------|---|---|--|
| 12/30/06 through 1/26/07 | 26,299                               | \$ 18.51                                  | -   | \$ 13.1 million  |
| 1/27/07 through 2/23/07  | 1,708,082                            | \$ 19.05                                  | 1,707,476   | \$ 55.5 million  |
| 2/24/07 through 3/30/07  | 2,381,095                            | \$ 18.58                                  | 2,372,935   | \$ 11.4 million  |



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|       |           |    |       |           |    |              |
|-------|-----------|----|-------|-----------|----|--------------|
| Total | 4,115,476 | \$ | 18.78 | 4,080,411 | \$ | 11.4 million |
|-------|-----------|----|-------|-----------|----|--------------|

(1) During the thirteen weeks ended March 30, 2007, we purchased 35,065 shares in order to satisfy 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.

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The table below includes repurchases of our common stock pursuant to publicly announced plans or programs and

**Item 3. Defaults Upon Senior Securities**

None.

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

No matters were submitted to a vote of security holders during the thirteen weeks ended March 30, 2007.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

Exhibits

- 10.1 First Amendment to the Executive Employment Agreement between Steven C. Cooper and Labor Ready, Inc., dated as of December 31, 2006
- 10.2 First Amendment to the Executive Employment Agreement between James E. Defebaugh and Labor Ready, Inc., dated as of December 31, 2006
- 10.3 Executive Employment Agreement between Noel Wheeler and Labor Ready, Inc., dated as of May 27, 2005, as amended by First Amendment to the Executive Employment Agreement between Noel Wheeler and Labor Ready, Inc., dated as of December 31, 2006
- 10.4 Executive Employment Agreement between Derrek L. Gafford and Labor Ready, Inc., dated as of December 31, 2006
- 10.5 Executive Employment Agreement between Chris D. Burger and Labor Ready, Inc., dated as of December 31, 2006
- 10.6 Executive Employment Agreement between Wayne W. Larkin and Labor Ready, Inc., dated as of December 31, 2006
- 10.7 Executive Employment Agreement between Richard L. Mercuri and Labor Ready, Inc., dated as of December 31, 2006
- 10.8 Form of Change In Control Agreement for executive officers
- 10.9 Form of Non-Competition Agreement for executive officers
- 10.10 Form of Indemnification Agreement for executive officers
- 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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**SIGNATURES**

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

**LABOR READY, INC.**

*/s/ Steven C. Cooper* *5/3/07*  
Signature Date  
By: Steven C. Cooper, Director, Chief Executive Officer  
and President

*/s/ Derrek L. Gafford* *5/3/07*  
Signature Date  
By: Derrek L. Gafford, Chief Financial Officer and Executive  
Vice President