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 September 30, 1997

Commission File No. 0-21886

BARRETT BUSINESS SERVICES, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland | 52-0812977 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| 4724 SW Macadam Avenue<br>Portland, Oregon | 97201 |
| (Address of principal executive offices) | (Zip Code) |

(503) 220-0988

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days.

Yes [ X ]                No [   ]

Number of shares of Common Stock, $.01 par value outstanding at October 31, 1997 was 6,727,423 shares.

BARRETT BUSINESS SERVICES, INC.

## INDEX

PART I - Financial Information

Item 1. Financial Statements

BARRETT BUSINESS SERVICES, INC.
Balance Sheets
(Unaudited)
(In thousands)

| | September 30, 1997 | December 31, 1996 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,754 | $ 1,901 |
| Trade accounts receivable, net | 24,376 | 19,057 |
| Note receivable | - | 324 |
| Prepaid expenses and other | 1,205 | 914 |
| Deferred tax asset (Note 4) | 1,708 | 1,279 |
| Total current assets | 29,043 | 23,475 |
| Intangibles, net | 12,434 | 10,226 |
| Property and equipment, net | 4,035 | 3,111 |
| Restricted marketable securities and workers' compensation deposits | 6,077 | 5,707 |
| Other assets | 139 | 127 |
| | $51,728 | $42,646 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Advances on credit line | $ 1,614 | $ - |
| Current portion of long-term debt | 62 | 36 |
| Accounts payable | 1,229 | 667 |
| Accrued payroll, payroll taxes and related benefits | 11,808 | 7,354 |
| Accrued workers' compensation claims liabilities | 2,750 | 2,240 |
| Customer safety incentives payable | 1,143 | 1,015 |
| Other accrued liabilities | 383 | 606 |
| Total current liabilities | 18,989 | 11,918 |
| Long-term debt, net of current portion | 810 | 838 |
| Customer deposits | 951 | 890 |
| Long-term workers' compensation liabilities | 606 | 613 |
| Other long-term liabilities | 1,022 | - |
| | 22,378 | 14,259 |
| Commitments and contingencies | | |
| Redeemable common stock, 159 shares issued and outstanding (Note 2) | - | 2,825 |
| Nonredeemable stockholders' equity: | | |
| Common stock, $.01 par value; 20,500 shares authorized, 6,727 and 6,625 shares issued and outstanding, respectively | 67 | 66 |
| Additional paid-in capital | 11,685 | 10,929 |
| Retained earnings | 17,598 | 14,567 |
| | 29,350 | 25,562 |
| | $51,728 | $42,646 |

The accompanying notes are an integral part of these financial statements.



BARRETT BUSINESS SERVICES, INC.
Statements of Operations
(Unaudited)
(In thousands, except per share amounts)

| | Three Months Ended September 30, 1997 | 1996 |
|---|---|---|
| Revenues: | | |
| Staffing services | $47,271 | $32,612 |
| Professional employer services | 33,934 | 27,640 |
| | 81,205 | 60,252 |
| Cost of revenues: | | |
| Direct payroll costs | 62,997 | 45,817 |
| Payroll taxes and benefits | 7,654 | 5,248 |
| Workers' compensation | 2,237 | 2,161 |
| Safety incentives | 464 | 433 |
| | 73,352 | 53,659 |
| Gross margin | 7,853 | 6,593 |
| Selling, general and administrative expenses | 6,072 | 4,104 |
| Amortization of intangibles | 351 | 207 |
| Income from operations | 1,430 | 2,282 |
| Other income (expense): | | |
| Interest expense | (60) | (20) |
| Interest income | 84 | 129 |
| Other, net | (2) | - |
| | 22 | 109 |
| Income before provision for income taxes | 1,452 | 2,391 |
| Provision for income taxes | 505 | 730 |
| Net income | $ 947 | $ 1,661 |
| Primary earnings per share (Note 6) | $ .14 | $ .24 |
| Primary weighted average number of common stock equivalent shares outstanding | 6,727 | 7,019 |

The accompanying notes are an integral part of these financial statements.



BARRETT BUSINESS SERVICES, INC.
Statements of Operations
(Unaudited)
(In thousands, except per share amounts)

| | Nine Months Ended September 30, 1997 | 1996 |
|---|---|---|
| Revenues: | | |
| Staffing services | $118,405 | $ 82,332 |
| Professional employer services | 96,035 | 72,976 |
| | 214,440 | 155,308 |

| | | |
|---|---|---|
| Cost of revenues: | | |
| Direct payroll costs | 165,200 | 117,695 |
| Payroll taxes and benefits | 20,907 | 14,570 |
| Workers' compensation | 6,065 | 4,144 |
| Safety incentives | 1,168 | 1,142 |
| | 193,340 | 137,551 |
| Gross margin | 21,100 | 17,757 |
| Selling, general and administrative expenses | 15,444 | 11,671 |
| Amortization of intangibles | 943 | 576 |
| Income from operations | 4,713 | 5,510 |
| Other income (expense): | | |
| Interest expense | (127) | (62) |
| Interest income | 273 | 380 |
| Other, net | (2) | - |
| | 144 | 318 |
| Income before provision for income taxes | 4,857 | 5,828 |
| Provision for income taxes | 1,826 | 2,036 |
| Net income | $ 3,031 | $ 3,792 |
| Primary earnings per share (Note 6) | $ .45 | $ .55 |
| Primary weighted average number of common stock equivalent shares outstanding | 6,754 | 6,928 |

The accompanying notes are an integral part of these financial statements.



BARRETT BUSINESS SERVICES, INC.
Statements of Cash Flows
(Unaudited)
(In thousands)

<TABLE>
<CAPTION>

| | Nine Months Ended September 30, 1997 | 1996 |
|---|---|---|
| <S> | <C> | <C> |
| Cash flows from operating activities: | | |
| Net income | $ 3,031 | $ 3,792 |
| Reconciliation of net income to cash from operations: | | |
| Depreciation and amortization | 1,230 | 799 |
| Changes in certain assets and liabilities, net of assets acquired and liabilities assumed: | | |
| Trade accounts receivable, net | (4,773) | (4,186) |
| Note receivable | 324 | - |
| Prepaid expenses and other | (232) | (304) |
| Deferred tax asset | (429) | (266) |
| Accounts payable | 553 | 336 |
| Accrued payroll, payroll taxes and related | | |

| | | |
|---|---|---|
| benefits | 4,447 | 2,426 |
| Accrued workers' compensation claims liabilities | 510 | (259) |
| Customer safety incentives payable | 128 | 261 |
| Income taxes payable | - | 648 |
| Other accrued liabilities | (347) | - |
| Customer deposits and long-term workers' compensation liabilities | 54 | 427 |
| Other long-term liabilities | 22 | - |
| | ------ | --- |
| Net cash provided by operating activities | 4,518 | 3,674 |
| | ------ | --- |
| Cash flows from investing activities: | | |
| Cash paid for acquisitions, including other direct costs (Note 3) | (2,246) | (685) |
| Purchases of fixed assets, net of amounts purchased in acquisitions | (1,137) | (301) |
| Proceeds from maturities of marketable securities | 5,338 | 5,493 |
| Purchases of marketable securities | (5,708) | (6,528) |
| | ------ | --- |
| Net cash used in investing activities | (3,753) | (2,021) |
| | ------ | --- |
| Cash flows from financing activities: | | |
| Payment of credit line assumed in acquisition | (401) | - |
| Proceeds from credit line borrowings | 1,614 | - |
| Payments on long-term debt | (57) | (24) |
| Repurchase of common stock | (2,825) | - |
| Proceeds from exercise of stock options and warrants | 757 | 109 |
| | ------ | --- |
| Net cash (used in) provided by financing activities | (912) | 85 |
| | ------ | --- |
| Net (decrease) increase in cash and cash equivalents | (147) | 1,738 |
| Cash and cash equivalents, beginning of period | 1,901 | 3,218 |
| | ------ | --- |
| Cash and cash equivalents, end of period | $ 1,754 | $ 4,956 |
| | ====== | ====== |
| Supplemental schedule of noncash activities: | | |
| Acquisition of other businesses: | | |
| Cost of acquisitions in excess of fair market value of net assets acquired | $ 3,179 | $ 3,450 |
| Tangible assets acquired | 674 | 492 |
| Liabilities assumed | 1,607 | 52 |
| Common stock issued in connection with acquisitions | - | 3,205 |

</TABLE>

The accompanying notes are an integral part of these financial statements.



BARRETT BUSINESS SERVICES, INC.
Notes to Financial Statements

NOTE 1 - BASIS OF PRESENTATION OF INTERIM PERIOD STATEMENTS:

The accompanying financial statements are unaudited and have been prepared by Barrett Business Services, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures typically included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods presented. The financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's 1996 Annual Report on Form 10-K at pages 28-51. The results of operations for an interim period are not necessarily indicative of the results of operations for a full year.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 128 "Earnings Per Share." SFAS 128 replaces APB Opinion 15, "Earnings Per Share," and simplifies the computation of EPS by replacing the presentation of primary EPS with a presentation of basic EPS. In accordance with this pronouncement, the Company will adopt the new standard for periods ending after December 15, 1997. The impact of the SFAS 128 EPS calculation for the three and nine-month periods ended September 30, 1997 is not material.

Certain prior year amounts have been reclassified to conform with the 1997 presentation. Such reclassifications had no impact on net income or stockholders' equity.

NOTE 2 - REDEEMABLE COMMON STOCK:

On April 11, 1997, pursuant to a Plan and Agreement of Reorganization between StaffAmerica, Inc. and the Company dated April 1, 1996, the Company repurchased from StaffAmerica and its two shareholders all 159,154 shares of common stock previously issued by the Company as consideration for the acquisition, for a total of $2,824,984 or $17.75 per share. Upon completion of the share repurchase, the Company canceled the shares of common stock.

NOTE 3 - ACQUISITIONS:

Effective February 1, 1997, the Company acquired D&L Personnel Department Specialists, Inc., dba HR Only, a staffing services company which specializes in human resource professionals with offices in Los Angeles and Orange County, California. The Company paid $1,800,000 in cash for all of the outstanding common stock of HR Only and $1,200,000 in cash for noncompete agreements with certain individuals, of which $1,000,000 will be deferred with



simple interest at 5% per annum for five years and then be paid ratably over the succeeding five-year period. The deferred portion of the noncompete agreement is presented on the balance sheet in other long-term liabilities. HR Only's revenues for the fiscal year ended January 31, 1997 were approximately $4.3 million. The transaction was accounted for under the purchase method of accounting, which resulted in $3,027,000 of intangible assets, including $92,000 for acquisition-related costs, and $65,000 of net tangible assets.

Effective April 13, 1997, the Company acquired certain assets of JRL Services, Inc., dba TLC Staffing, a provider of clerical staffing services located in Tucson, Arizona. TLC Staffing had revenues of approximately $800,000 (unaudited) for the year ended December 31, 1996. The Company paid $150,000 in cash for the assets, assumed an $18,000 office lease liability and incurred approximately $4,000 in acquisition related costs. The transaction was accounted for under the purchase method of accounting, which resulted in $152,000 of intangible assets and $2,000 of fixed assets.

NOTE 4 - PROVISION FOR INCOME TAXES:

Deferred tax assets (liabilities) are comprised of the following components (in thousands):

<TABLE>

| | September 30, 1997 | December 31, 1996 |
|---|---|---|
| <S> | <C> | <C> |
| Accrued workers' compensation claims liabilities | $1,320 | $1,113 |
| Allowance for doubtful accounts | 133 | 10 |
| Tax depreciation in excess of book depreciation | (164) | (154) |
| Safety incentives | 331 | 281 |
| Book amortization of intangibles in excess of tax amortization | 88 | 29 |
| | $1,708 | $1,279 |

</TABLE>

The provision for income taxes for the nine months ended September 30, 1997 and 1996, is as follows (in thousands):

<TABLE>

| | Nine Months Ended Sept. 30, 1997 | Nine Months Ended Sept. 30, 1996 |
|---|---|---|
| Current: | | |
| <S> | <C> | <C> |
| Federal | $1,892 | $2,045 |
| State | 363 | 257 |
| | 2,255 | 2,302 |
| Deferred: | | |
| Federal | (355) | (221) |
| State | (74) | (45) |
| | (429) | (266) |
| Provision for income taxes | $1,826 | $2,036 |

</TABLE>



During the third quarter of 1997, the Company recognized, net of federal tax, a State of Oregon tax credit of approximately $61,000 related to surplus tax revenues collected by the State for prior tax years. The State is statutorily required to provide credits or refunds to taxpayers for excess tax revenues collected.

NOTE 5 - STOCK INCENTIVE PLAN:

In 1993, the Company adopted a stock incentive plan (the "Plan") which provides for stock-based awards to the Company's employees, directors and outside consultants or advisers. The number of shares of common stock reserved for issuance under the Plan is 1,300,000.

The following table summarizes options granted under the Plan in 1997:

| | | |
|---|---|---|
| Outstanding at December 31, 1996 | 491,998 | $ 3.50 to $16.36 |
| Options granted | 166,011 | $13.38 to $17.94 |
| Options exercised | (42,375) | $ 3.50 to $15.06 |
| Options canceled or expired | (39,375) | $ 3.50 to $15.06 |
| Outstanding at September 30, 1997 | 576,259 | $ 3.50 to $17.94 |
| Exercisable at September 30, 1997 | 228,208 | |
| Available for grant at September 30, 1997 | 557,616 | |

=======

The options listed in the table generally become exercisable in four equal annual installments beginning one year after the date of grant.

NOTE 6 - NET INCOME PER SHARE:

Net income per share for 1997 is computed based on the weighted average number of actual shares of common stock outstanding during the period, without giving effect to securities that would otherwise be considered to be common stock equivalents because such securities aggregate less than 3% of shares outstanding and, thus, are not considered dilutive. Net income per share for 1996 is computed based on the weighted average number of common stock and common stock equivalent shares outstanding during the period; common stock equivalents aggregated more than 3% of shares outstanding for such period.



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

Results of Operations

The following table sets forth the percentages of total revenues represented by selected items in the Company's Statements of Operations for the three and nine-month periods ended September 30, 1997 and 1996.

<TABLE>

| | Percentage of Total Revenues | | | |
|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 1997 | 1996 | 1997 | 1996 |
| Revenues: | | | | |
| <S> | <C> | <C> | <C> | <C> |
| Staffing services | 58.2% | 54.1% | 55.2% | 53.0% |
| Professional employer services | 41.8 | 45.9 | 44.8 | 47.0 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues: | | | | |
| Direct payroll costs | 77.6 | 76.0 | 77.0 | 75.8 |
| Payroll taxes and benefits | 9.4 | 8.8 | 9.8 | 9.4 |
| Workers' compensation | 2.8 | 3.6 | 2.8 | 2.7 |
| Safety incentives | .5 | .7 | .6 | .7 |
| Total cost of revenues | 90.3 | 89.1 | 90.2 | 88.6 |
| Gross margin | 9.7 | 10.9 | 9.8 | 11.4 |
| Selling, general and administrative expenses | 7.5 | 6.8 | 7.2 | 7.5 |
| Amortization of intangibles | .4 | .3 | .4 | .4 |
| Income from operations | 1.8 | 3.8 | 2.2 | 3.5 |
| Other income (expense) | - | .2 | .1 | |

| | | | | |
|---|---|---|---|---|
| | | | | .2 |
| Pretax income | 1.8 | 4.0 | 2.3 | 3.7 |
| Provision for income taxes | .6 | 1.2 | .9 | 1.3 |
| Net income | 1.2 | 2.8 | 1.4 | 2.4 |

</TABLE>

Three months ended September 30, 1997 and 1996

Net income for the third quarter of 1997 was $947,000, a decrease of $714,000 or 43.0% from the same period in 1996. The decrease in net income was attributable to a lower gross margin percentage and increased selling, general and administrative expenses. Earnings per share for the third quarter of 1997 were $.14, as compared to $.24 for the third quarter of 1996.

Revenues for the third quarter of 1997 totaled approximately $81.2 million, an increase of approximately $21.0 million or 34.8% over the third quarter of 1996. The quarter-over-quarter internal growth rate of revenues was 27.0%. The percentage increase in total revenues exceeded the internal growth rate of revenues primarily due to the acquisition of four staffing and PEO businesses since October 1, 1996.



The higher internal growth rate of revenues of 27.0% for the 1997 third quarter compared to 14.6% for the 1996 third quarter was primarily attributable to the opening of four new branch offices during 1996 and early 1997 in Boise, Idaho, Tucson, Arizona, Ontario, California, and Flint, Michigan, coupled with the continued growth in business at existing branch offices. Staffing services revenues increased approximately $14.7 million or 44.9%, while professional employer services revenues increased approximately $6.3 million or 22.8%, which resulted in an increase in the mix of staffing services to 58.2% of total revenues for the third quarter of 1997, as compared to 54.1% for the third quarter of 1996. The mix of professional employer services revenues had a corresponding decline from 45.9% for the third quarter of 1996 to 41.8% for the third quarter of 1997.

Gross margin for the third quarter of 1997 totaled approximately $7.9 million, which represented an increase of $1.3 million or 19.1% over the third quarter of 1996. Gross margin as a percentage of revenues, however, decreased to 9.7% of revenues for the third quarter of 1997, as compared to 10.9% for the same period of 1996. The decline in the gross margin percentage was due to higher direct payroll costs and payroll taxes and benefits, both in terms of total dollars and as a percentage of revenues. The effect of these higher costs was offset in part by lower workers' compensation expense as a percentage of revenues.

The increase in the percentage of direct payroll costs from 76.0% for the third quarter of 1996 to 77.6% for the third quarter of 1997 was primarily attributable to increased business activity in contract staffing and on-site management arrangements, which are typically higher volume, lower margin accounts. In many of these staffing arrangements, the Company acts as the master vendor, while other staffing services companies ("subcontractors") participate in the contract. Under such arrangements, the other staffing companies invoice Barrett for employees provided to Barrett. Barrett in turn invoices the customer at the subcontractors' invoice cost, which results in a pass-through of costs with no gross margin realized by the Company in accordance with industry practice. These pass-through costs, however, increase the percentage of revenues represented by direct payroll costs yielding a lower gross margin percentage.

During the third quarter of 1997, subcontractor labor costs totaled approximately $1.1 million, compared to approximately $300,000 for the 1996 third quarter. The impact of the subcontractor costs for the third quarter of 1997 was an increase of approximately 30 basis points in the direct payroll costs expressed as a percentage of revenues. In view of the dynamics of competitive market forces, including the increasing volume of large contract staffing and on-site management staffing contracts, there can be no assurance that the percentage of revenues represented by direct payroll costs will return to historical levels.

The increase in the percentage of payroll taxes and benefits from 8.8% of revenues for the third quarter of 1996 to 9.4% for the third quarter of 1997 was primarily due to the increase in seasonal employment and incremental new business in

California, which has a relatively high state unemployment tax rate.

Workers' compensation expense decreased from 3.6% of revenues for the third quarter of 1996 to 2.8% of revenues for the 1997 third quarter due to an overall reduction in severity of injuries. The 2.8% of revenues for the 1997 third quarter represents current loss experience for the third quarter and management's decision to (i) continue to increase the Company's accrual for future adverse loss development of open claims, and (ii) build an accrual for potential future catastrophic workers' compensation claims.

The following table summarizes certain indicators of experience regarding the Company's self-insured workers' compensation program for each of the first three quarters of 1997 and 1996.

Self-Insured Workers' Compensation Profile

<TABLE>

| | No. of Injury Claims | | Total Workers' Comp Expense (in thousands) | | Total Workers' Comp Expense as a % of Total Payroll | |
|---|---|---|---|---|---|---|
| | 1997 | 1996 | 1997 | 1996 | 1997 | 1996 |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Q1 | 321 | 193 | $1,855 | $ 770 | 3.9% | 2.4% |
| Q2 | 419 | 312 | 1,973 | 1,213 | 3.6 | 3.1 |
| Q3 | 578 | 401 | 2,237 | 2,161 | 3.6 | 4.7 |
| YTD | 1,318 | 906 | $6,065 | $4,144 | 3.7% | 3.5% |

</TABLE>

Selling, general and administrative ("SG&A") expenses for the 1997 third quarter amounted to approximately $6.1 million, an increase of approximately $2.0 million or 48.0% over the comparable period in 1996. Selling, general and administrative expenses expressed as a percentage of revenues increased from 6.8% for the 1996 third quarter to 7.5% for the 1997 third quarter primarily due to an increase in bad debt expense attributable to a single customer of $250,000, coupled with the addition of high-quality personnel at several branches in order to better manage and grow the Company's business. Management believes that the Company's allowance for doubtful accounts is adequate at September 30, 1997. There can be no assurance, however, that future experience with respect to the Company's ability to collect accounts receivable will not be adverse. The increase in total SG&A dollars was also attributable to incremental branch office expenses as a result of the four acquisitions since October 1, 1996, as well as the opening of four new offices in 1996 and early 1997.

Amortization of intangibles totaled $351,000, or .4% of revenues, for the third quarter of 1997, which compares to $207,000 or .3% of revenues for the same period in 1996. The increased amortization expense was primarily due to the Company's four acquisitions since October 1, 1996.

The Company offers various employee benefit plans to its employees, including its worksite employees. These employee



benefit plans include a savings plan (the "401(k) plan") under Section 401(k) of the Internal Revenue Code (the "Code"), a cafeteria plan under Code Section 125, a group health plan, a group life insurance plan, a group disability insurance plan, and an employee assistance plan. Generally, employee benefit plans are subject to provisions of both the Code and the Employee Retirement Income Security Act ("ERISA"). In order to qualify for favorable tax treatment under the Code, qualified plans must be established and maintained by an employer for the exclusive benefit of its employees. In the event the tax exempt status of the Company's benefit plans were to be discontinued and the benefit plans were to be disqualified, such actions could have a material adverse effect on the Company's business, financial condition, and results of operations. Reference is made to pages 12-14 of the Company's 1996 Annual Report on Form 10-K for a more detailed discussion of this issue.

Nine Months Ended September 30, 1997 and 1996

Net income for the nine months ended September 30, 1997 was $3,031,000, a decrease of $761,000 or 20.0% from the same period in 1996. The decrease in net income was primarily due to a lower gross margin percentage owing primarily to increased direct payroll costs. Net income per share for the nine months ended September 30, 1997 was $.45, as compared to $.55 for the nine months ended September 30, 1996.

Revenues for the nine months ended September 30, 1997 totaled approximately $214.4 million, an increase of approximately $59.1 million or 38.1% over the comparable period of 1996. The internal growth rate of revenues was 25.8%. The growth rate of total revenues exceeded the internal growth rate of revenues primarily due to the acquisition of four staffing and PEO businesses between November 1996 and April 1997.

The higher internal growth rate of revenues of 25.8% for 1997 compared to the 1996 period internal growth rate of 8.6% was primarily attributable to the opening of four new branch offices during 1996 and in early 1997, coupled with the continued growth in business at existing branch offices.

Gross margin for the nine months ended September 30, 1997 totaled approximately $21.1 million, which represented an increase of $3.3 million or 18.8% over the same period of 1996. The gross margin percent decreased to 9.8% of revenues for the first nine months of 1997, as compared to 11.4% for the same period of 1996. The decline in the gross margin percentage was primarily due to higher direct payroll costs both in terms of total dollars and as a percentage of revenues. The increase in the percentage of direct payroll costs from 75.8% for the first nine months of 1996 to 77.0% for the first nine months of 1997 was primarily attributable to increased business activity in contract staffing and on-site management arrangements.

Selling, general and administrative expenses for the nine months ended September 30, 1997 amounted to approximately $15.4 million, an increase of $3.8 million or 32.3% over the comparable



period in 1996. These expenses, however, decreased from 7.5% of revenues for the 1996 period to 7.2% of revenues for 1997. The increase in total dollars was primarily attributable to additional branch office expenses as a result of the four acquisitions made since October 1, 1996, and the opening of four new offices.

Amortization of intangibles totaled $943,000 or .4% of revenues for the nine-month period ended September 30, 1997, which compares to $576,000 for the same period in 1996. The increased amortization expense was attributable to the four acquisitions made since October 1, 1996.

Fluctuations in Quarterly Operating Results

The Company has historically experienced significant fluctuations in its quarterly operating results and expects such fluctuations to continue in the future. The Company's operating results may fluctuate due to a number of factors such as seasonality, wage limits on payroll taxes, claims expense for workers' compensation, demand and competition for the Company's services, and the effect of acquisitions. The Company's revenue levels fluctuate from quarter to quarter primarily due to the impact of seasonality in its staffing services business and on certain of its PEO clients in the agriculture and forest products related industries. As a result, the Company may have greater revenues and net income in the third and fourth quarters of its fiscal year. Payroll taxes and benefits fluctuate with the level of direct payroll costs but may tend to represent a smaller percentage of revenues later in the Company's fiscal year as federal and state statutory wage limits for unemployment and social security taxes are exceeded by employees. Workers' compensation expense varies with both the frequency and severity of workplace injury claims reported during a quarter, as well as adverse loss development of prior period claims during the current quarter.

Liquidity and Capital Resources
- -------------------------------

The Company's cash position of $1,754,000 at September 30, 1997 decreased by $147,000 from December 31, 1996. The decrease was primarily due to cash used in investing activities for acquisitions and in financing activities to satisfy the Company's obligation to repurchase shares of its common stock, offset in part by the cash provided by operating activities.

Net cash provided by operating activities for the nine months ended September 30, 1997 amounted to $4,518,000 as compared to $3,674,000 for the comparable 1996 period. For the 1997 period, cash flow generated by net income, together with an increase of $4,447,000 in accrued payroll and benefits, was offset in part by a $4,773,000 increase in trade accounts receivable. The $1,022,000 increase in other long-term liabilities includes the $1,000,000 deferred noncompete agreement arising from the acquisition of HR Only and is reflected in the supplemental schedule of noncash activities within the "liabilities assumed" caption.

Net cash used in investing activities totaled $3,753,000 for the nine months ended September 30, 1997, as compared to

$2,021,000 for the similar 1996 period. For the 1997 period, the principal uses of cash for investing activities were the acquisition of HR Only and the purchase of new computer hardware, as well as capitalized software implementation costs, in connection with the Company's new management information system which will, among other things, address the "Year 2000" issue. The Company presently has no material long-term capital commitments.

Net cash used in financing activities for the nine-month period ended September 30, 1997 was $912,000, which compares to net cash provided by financing activities of $85,000 for the comparable 1996 period. For the 1997 period, the principal use of cash for financing activities arose from the Company's obligation to redeem 159,154 shares of its common stock at a value of $2,824,984 pursuant to a Plan and Agreement of Reorganization between StaffAmerica, Inc. and the Company. The cash used for this stock redemption was offset in part by net proceeds from borrowings on the Company's revolving bank credit line in the amount of $1,614,000 and proceeds from the exercise of stock options and warrants totaling $757,000. As of the date of this report, an underwriter continues to hold warrants to purchase 30,000 shares of common stock at $4.20 per share issued in connection with the Company's 1993 initial public offering of its common stock.

The Company's business strategy continues to focus on growth through the acquisition of additional personnel-related businesses, both in its existing markets and other strategic geographic areas, together with the expansion of operations at existing offices. As disclosed in Note 3 to the financial statements included herein, the Company purchased, during February 1997, a staffing services company located in the Los Angeles, California area for $2,092,000 in cash, plus an additional $1,000,000 for a noncompete agreement which will be paid ratably, with accrued interest, over five years beginning after the end of the fifth year following the acquisition. As also disclosed in Note 3, the Company purchased in April 1997, certain assets of a staffing services company located in Tucson, Arizona for $154,000 in cash. The Company actively explores proposals for various acquisition opportunities on an ongoing basis, but there can be no assurance that any additional transactions will be consummated.

The Company maintains an unsecured $4.0 million revolving credit facility with its principal bank and $1.6 million for standby letters of credit in connection with certain workers' compensation surety arrangements. Management expects the funds anticipated to be generated from operations, together with the credit facility and other potential sources of financing, will be sufficient in the aggregate to fund the Company's working capital needs for the foreseeable future.

Inflation

Inflation generally has not been a significant factor in the Company's operations during the periods discussed above. The Company has taken into account the impact of escalating medical and other costs in establishing reserves for future expenses for self-insured workers' compensation claims.



Forward-Looking Information
- ---------------------------

Statements in this report which are not historical in nature, including discussion of economic conditions in the Company's market areas, the potential for and effect of future acquisitions, the effect of changes in the Company's mix of services on gross margin, the adequacy of the Company's workers' compensation reserves and allowance for doubtful accounts, the tax-qualified status of the Company's 401(k) savings plan, the outcome of various legal proceedings, and the availability of financing and working capital to meet the Company's funding requirements, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors with respect to the Company include difficulties associated with integrating acquired businesses and clients into the Company's operations, economic trends in the Company's service areas, uncertainties regarding government regulation of PEOs, including the possible adoption by the IRS of an unfavorable position as to the tax-qualified status of employee benefit plans maintained by PEOs, future workers' compensation claims experience, future experience in the collection of accounts receivable, and the availability of and costs associated with potential sources of financing. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

## Part II - Other Information

### Item 1. Legal Proceedings

A lawsuit was filed in the Circuit Court of the State of Oregon for the County of Multnomah on February 5, 1997, by Javier and Ester Munoz, husband and wife, against Asger M. Nielson, doing business as Nielson and Son ("Nielson"), Rain-Master Roofing, Inc. ("Rain-Master"), and the Company. Mr. Munoz was employed by the Company under a PEO arrangement with Rain-Master, which is in the roofing business. On February 1, 1995, Rain-Master was providing roofing services at a construction site for which Nielson was serving as a general contractor. Mr. Munoz fell from the roof at the site in the course of his employment and is now a paraplegic as a result of the injuries he suffered. Until the filing of the lawsuit referred to above, Mr. Munoz's claim was being defended as a workers' compensation claim. In the lawsuit, the plaintiffs are seeking damages in the amount of $10,000,000 pursuant to claims for relief based on employer liability, intentional injury, product liability, negligence, breach of implied warranty and loss of consortium. On July 14, 1997, the court granted the Company's motion to dismiss the Company as a party to the lawsuit. The dismissal was without prejudice. The plaintiffs and the Company have agreed that the dismissal of the plaintiffs' suit be with prejudice and, therefore, the plaintiffs will be barred from refiling their suit against the Company. Nielson had previously filed a cross-claim against the Company for indemnity and contribution based on the same grounds as the plaintiffs' suit. Nielson has agreed to voluntarily dismiss the cross-claim against the Company.

On March 11, 1997, a Notice of Intent to Revoke Farm/Forest Labor Contractor License and to Assess Civil Penalties (the "Notice") was served on the Company by the Bureau of Labor and Industries of the State of Oregon (the "Bureau"). The Notice also names Daniel A. Hatfield, an employee of the Company. The Notice proposes to assess civil penalties in the amount of $488,000, based on the numbers of workers allegedly affected, for alleged noncompliance with various duties imposed on farm labor contracts by Oregon law, including licensing violations, failure to comply with wage payment laws, and failure to maintain and to provide workers and the Bureau with required documentation. A default judgment entered against the Company was withdrawn by an administrative law judge on April 23, 1997. An administrative hearing commenced in late September 1997 and is presently subject to a continuance to provide more time for discovery. Management is vigorously contesting the claims asserted in the Notice.



### Item 6. Exhibits and Reports on Form 8-K

(a) The exhibits filed herewith are listed in the Exhibit Index following the signature page of this report.

(b) No Current Reports on Form 8-K were filed by the Registrant during the quarter ended September 30, 1997.



## SIGNATURES

Pursuant to the requirements 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.

BARRETT BUSINESS SERVICES, INC.
(Registrant)

Date: November 12, 1997

By: /s/ Michael D. Mulholland
Michael D. Mulholland
Vice President-Finance
(Principal Financial Officer)



## EXHIBIT INDEX

| EXHIBIT | |
|---|---|
| 11 | Statement of Calculation of Average Common Shares Outstanding |
| 27 | Financial Data Schedule |

EXHIBIT 11

BARRETT BUSINESS SERVICES, INC.
STATEMENT OF CALCULATION OF AVERAGE
COMMON SHARES OUTSTANDING

<TABLE>

| | Three Months Ended September 30, 1997 |
|---|---|
| Primary Earnings Per Share: | |
| <S> | <C> |
| Weighted average number of shares | 6,727,423 |
| Stock option plan shares to be issued at prices ranging from $3.50 to $17.9375 per share | 559,431 |
| Warrant issues at a price of $4.20 per share | 30,000 |
| Less: Assumed purchase at average market price during the period using proceeds received upon exercise of options and purchase of stock, and using tax benefits of compensation due to premature dispositions | (458,953) |
| Total Primary Shares | 6,857,901 |
| Fully Diluted Earnings Per Share: | |
| Weighted average number of shares | 6,727,423 |
| Stock option plan shares to be issued at prices ranging from $3.50 to $17.9375 per share | 559,431 |
| Warrant issues at a price of $4.20 per share | 30,000 |
| Less: Assumed purchase at the higher of ending or average market price during the period using proceeds received upon exercise of options and purchase of stock, and using tax benefits of compensation due to premature dispositions | (439,929) |
| Total Diluted Shares | 6,876,925 |

</TABLE>

Note: The effect of common stock equivalents upon the primary and fully diluted earnings per share calculation is less than 3%; therefore, earnings per share are based on the weighted average number of shares outstanding during the period.

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