

BARRETT BUSINESS SERVICES INC  
Form 10-Q  
August 10, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

**For the Quarterly Period Ended June 30, 2009**

**Commission File No. 0-21886**

**BARRETT BUSINESS SERVICES, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of

**52-0812977**  
(IRS Employer

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incorporation or organization)

Identification No.)

8100 NE Parkway Drive, Suite 200

Vancouver, Washington  
(Address of principal executive offices)

(360) 828-0700

98662  
(Zip Code)

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Number of shares of common stock, \$.01 par value, outstanding at July 31, 2009 was 10,356,908 shares.

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## Part I - Financial Information

**Item 1. Financial Statements**

## BARRETT BUSINESS SERVICES, INC.

## Consolidated Balance Sheets

(Unaudited)

(In thousands, except per share amounts)

|   | June 30,<br>2009 | December 31,<br>2008 |
|---|------------------|----------------------|
| <b>ASSETS</b>   |                  |                      |
| Current assets:   |                  |                      |
| Cash and cash equivalents   | \$ 27,137        | \$ 42,214            |
| Marketable securities   | 13,114           | 17,968               |
| Trade accounts receivable, net                                      | 41,466           | 34,389               |
| Income taxes receivable   | 2,555            |                      |
| Prepaid expenses and other  | 2,796            | 1,440                |
| Deferred income taxes   | 3,781            | 2,373                |
| Workers' compensation receivables for insured claims                | 225              | 225                  |
| Total current assets  | 91,074           | 98,609               |
| Marketable securities   | 11,184           | 427                  |
| Goodwill, net   | 47,338           | 47,338               |
| Property, equipment and software, net                               | 15,265           | 15,503               |
| Restricted marketable securities and workers' compensation deposits | 3,283            | 2,701                |
| Other assets  | 1,639            | 1,645                |
| Workers' compensation receivables for insured losses and recoveries | 3,626            | 3,837                |
|   | \$ 173,409       | \$ 170,060           |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|   |        |        |
|---|--------|--------|
| Current liabilities:  |        |        |
| Accounts payable  | \$ 876 | \$ 881 |
| Accrued payroll, payroll taxes and related benefits                   | 38,851 | 32,296 |
| Other accrued liabilities   | 453    | 902    |
| Workers' compensation claims liabilities                              | 11,299 | 7,186  |
| Workers' compensation claims liabilities for insured claims           | 225    | 225    |
| Safety incentives liability   | 4,593  | 4,626  |
| Total current liabilities   | 56,297 | 46,116 |
| Customer deposits   | 626    | 706    |
| Long-term workers' compensation claims liabilities                    | 13,667 | 5,235  |
| Long-term workers' compensation claims liabilities for insured claims | 2,366  | 2,438  |
| Deferred income taxes   | 2,946  | 4,394  |
| Deferred gain on sale and leaseback                                   | 488    | 549    |
| Commitments and contingencies   |        |        |

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| Stockholders' equity:  |            |            |
|--|------------|------------|
| Preferred stock, \$.01 par value; 500,000 shares authorized; no shares issued and outstanding            |            |            |
| Common stock, \$.01 par value; 20,500 shares authorized, 10,357 and 10,583 shares issued and outstanding | 104        | 106        |
| Additional paid-in capital   | 28,849     | 30,959     |
| Other comprehensive income   | 113        | 25         |
| Retained earnings  | 67,953     | 79,532     |
|  | 97,019     | 110,622    |
|  | \$ 173,409 | \$ 170,060 |

The accompanying notes are an integral part of these financial statements

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## BARRETT BUSINESS SERVICES, INC.

## Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share amounts)

|  | Three Months Ended<br>June 30, |                 |
|--|--------------------------------|-----------------|
|  | 2009                           | 2008            |
| <b>Revenues:</b>   |                                |                 |
| Staffing services  | \$ 28,002                      | \$ 40,604       |
| Professional employer service fees                         | 29,263                         | 31,579          |
| <b>Total revenues</b>                                      | <b>57,265</b>                  | <b>72,183</b>   |
| <b>Cost of revenues:</b>                                   |                                |                 |
| Direct payroll costs                                       | 21,127                         | 29,943          |
| Payroll taxes and benefits                                 | 19,434                         | 20,721          |
| Workers compensation                                       | 18,927                         | 7,465           |
| <b>Total cost of revenues</b>                              | <b>59,488</b>                  | <b>58,129</b>   |
| <b>Gross margin</b>  | <b>(2,223)</b>                 | <b>14,054</b>   |
| Selling, general and administrative expenses               | 8,336                          | 9,165           |
| Depreciation and amortization                              | 410                            | 382             |
| <b>(Loss) income from operations</b>                       | <b>(10,969)</b>                | <b>4,507</b>    |
| <b>Other income:</b>                                       |                                |                 |
| Investment income, net                                     | 239                            | 535             |
| Other  | 54                             | 52              |
| <b>Other income</b>  | <b>293</b>                     | <b>587</b>      |
| <b>(Loss) income before income taxes</b>                   | <b>(10,676)</b>                | <b>5,094</b>    |
| <b>(Benefit from) provision for income taxes</b>           | <b>(3,944)</b>                 | <b>1,844</b>    |
| <b>Net (loss) income</b>                                   | <b>\$ (6,732)</b>              | <b>\$ 3,250</b> |
| <b>Basic (loss) earnings per share</b>                     | <b>\$ (.65)</b>                | <b>\$ .30</b>   |
| <b>Weighted average number of basic shares outstanding</b> | <b>10,355</b>                  | <b>10,937</b>   |
| <b>Diluted (loss) earnings per share</b>                   | <b>\$ (.65)</b>                | <b>\$ .29</b>   |

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Weighted average number of diluted shares outstanding

10,355

11,221

The accompanying notes are an integral part of these financial statements

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## BARRETT BUSINESS SERVICES, INC.

## Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share amounts)

|  | Six Months Ended<br>June 30, |                 |
|--|------------------------------|-----------------|
|  | 2009                         | 2008            |
| <b>Revenues:</b>   |                              |                 |
| Staffing services  | \$ 52,044                    | \$ 76,423       |
| Professional employer service fees                         | 56,293                       | 61,954          |
| <b>Total revenues</b>                                      | <b>108,337</b>               | <b>138,377</b>  |
| <b>Cost of revenues:</b>                                   |                              |                 |
| Direct payroll costs                                       | 39,196                       | 56,326          |
| Payroll taxes and benefits                                 | 42,061                       | 45,166          |
| Workers compensation                                       | 25,614                       | 14,269          |
| <b>Total cost of revenues</b>                              | <b>106,871</b>               | <b>115,761</b>  |
| <b>Gross margin</b>  | <b>1,466</b>                 | <b>22,616</b>   |
| Selling, general and administrative expenses               | 16,376                       | 17,834          |
| Depreciation and amortization                              | 796                          | 758             |
| <b>(Loss) income from operations</b>                       | <b>(15,706)</b>              | <b>4,024</b>    |
| <b>Other income:</b>                                       |                              |                 |
| Investment income, net                                     | 489                          | 1,173           |
| Other  | (81)                         | 40              |
| <b>Other income</b>  | <b>408</b>                   | <b>1,213</b>    |
| <b>(Loss) income before income taxes</b>                   | <b>(15,298)</b>              | <b>5,237</b>    |
| <b>(Benefit from) provision for income taxes</b>           | <b>(5,392)</b>               | <b>1,896</b>    |
| <b>Net (loss) income</b>                                   | <b>\$ (9,906)</b>            | <b>\$ 3,341</b> |
| <b>Basic (loss) earnings per share</b>                     | <b>\$ (.95)</b>              | <b>\$ .30</b>   |
| <b>Weighted average number of basic shares outstanding</b> | <b>10,426</b>                | <b>11,012</b>   |
| <b>Diluted (loss) earnings per share</b>                   | <b>\$ (.95)</b>              | <b>\$ .30</b>   |



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|   |        |        |
|---|--------|--------|
| Weighted average number of diluted shares outstanding | 10,426 | 11,322 |
|---|--------|--------|

The accompanying notes are an integral part of these financial statements

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## BARRETT BUSINESS SERVICES, INC.

## Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

|   | <b>Six Months Ended<br/>June 30,</b> |                |
|---|--------------------------------------|----------------|
|   | <b>2009</b>                          | <b>2008</b>    |
| <b>Cash flows from operating activities:</b>  |                                      |                |
| Net (loss) income   | \$ (9,906)                           | \$ 3,341       |
| <b>Reconciliations of net (loss) income to net cash provided by (used in) operating activities:</b> |                                      |                |
| Depreciation and amortization   | 796                                  | 758            |
| Losses (gains) recognized on marketable securities  | 80                                   | (42)           |
| Purchase of marketable securities   |                                      | (31)           |
| Gain recognized on sale and leaseback   | (61)                                 | (61)           |
| Deferred income taxes   | (2,911)                              | 2              |
| Share based compensation  | 50                                   |                |
| <b>Changes in certain assets and liabilities, net of amounts purchased in acquisitions:</b>         |                                      |                |
| Trade accounts receivable, net  | (7,077)                              | (8,623)        |
| Income taxes receivable   | (2,555)                              |                |
| Prepaid expenses and other  | (1,356)                              | 342            |
| Accounts payable  | (5)                                  | (304)          |
| Accrued payroll, payroll taxes and related benefits   | 6,555                                | 4,302          |
| Income taxes payable  |                                      | 527            |
| Other accrued liabilities   | (449)                                | (351)          |
| Workers' compensation claims liabilities  | 12,684                               | 2,225          |
| Safety incentives liability   | (33)                                 | (1,248)        |
| Customer deposits and other assets, net   | (100)                                | (101)          |
| <b>Net cash (used in) provided by operating activities</b>  | <b>(4,288)</b>                       | <b>736</b>     |
| <b>Cash flows from investing activities:</b>  |                                      |                |
| Cash paid for acquisitions, including other direct costs  |                                      | (3,838)        |
| Purchase of property and equipment, net of amounts purchased in acquisitions                        | (532)                                | (441)          |
| Proceeds from sales and maturities of marketable securities   | 8,169                                | 72,378         |
| Purchase of marketable securities   | (14,009)                             | (55,356)       |
| Proceeds from maturities of restricted marketable securities  | 1,982                                | 1,693          |
| Purchase of restricted marketable securities  | (2,564)                              | (2,839)        |
| <b>Net cash (used in) provided by investing activities</b>  | <b>(6,954)</b>                       | <b>11,597</b>  |
| <b>Cash flows from financing activities:</b>  |                                      |                |
| Proceeds from credit-line borrowings  | 323                                  | 5,040          |
| Payments on credit-line borrowings  | (323)                                | (5,040)        |
| Proceeds from exercise of stock options   | 19                                   | 221            |
| Dividends paid  | (1,673)                              | (1,752)        |
| Repurchase of common stock  | (2,194)                              | (3,997)        |
| Tax benefit of stock option exercises   | 13                                   | 58             |
| <b>Net cash used in financing activities</b>  | <b>(3,835)</b>                       | <b>(5,470)</b> |

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|  |           |           |
|--|-----------|-----------|
| Net (decrease) increase in cash and cash equivalents                       | (15,077)  | 6,863     |
| Cash and cash equivalents, beginning of period                             | 42,214    | 9,777     |
| Cash and cash equivalents, end of period                                   | \$ 27,137 | \$ 16,640 |
| Supplemental schedule of noncash investing activities:                     |           |           |
| Acquisitions of other businesses:  |           |           |
| Cost of acquisitions in excess of fair market value of net assets acquired | \$        | \$ 3,808  |
| Intangible assets acquired   |           | 15        |
| Tangible assets acquired   |           | 15        |
| Net cash paid for acquisitions   | \$        | \$ 3,838  |

The accompanying notes are an integral part of these financial statements

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited)

**Note 1 - Basis of Presentation of Interim Period Statements**

The accompanying consolidated financial statements are unaudited and have been prepared by Barrett Business Services, Inc. ( Barrett , BBSI or 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 accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the consolidated 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 preparation of financial statements in conformity with generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from such estimates and assumptions. The consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s 2008 Annual Report on Form 10-K at pages F1 - F25. The results of operations for an interim period are not necessarily indicative of the results of operations for a full year.

**Marketable securities**

As of June 30, 2009, the Company s marketable securities consisted of tax-exempt municipal securities, variable rate demand notes ( VRDN ), closed-end bond funds, equity securities, U.S. treasuries and corporate bonds. The Company classifies municipal securities, VRDN, the closed-end bond funds, U.S. treasuries and certain of its corporate bonds as available for sale; they are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of other comprehensive income (loss) in stockholders equity. In the event a loss is determined to be other-than-temporary, the loss will be recognized in the statement of operations. The equity securities are classified as trading and are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of net income. Certain of the Company s corporate bonds are classified as held-to-maturity and are reported at amortized cost.

**Allowance for doubtful accounts**

The Company had an allowance for doubtful accounts of \$306,000 and \$409,000 at June 30, 2009 and December 31, 2008, respectively. The Company must make estimates of the collectibility of accounts receivable. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic conditions and changes in customers payment trends when evaluating the adequacy of the allowance for doubtful accounts. The Company deems an account balance uncollectible only after it has pursued all available assets of the customer and, where applicable, the assets of the personal guarantor.

**Workers compensation claims**

The Company is a self-insured employer with respect to workers compensation coverage for all of its employees (including employees subject to Professional Employer Organization ( PEO ) contracts) working in California, Oregon, Maryland, Delaware and Colorado. In the state of Washington, state law allows only the Company s staffing services and internal management employees to be covered under the Company s self-insured workers compensation program. To manage our financial exposure, in the event of catastrophic injuries

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) *(Continued)*

**Note 1 - Basis of Presentation of Interim Period Statements (Continued)**

**Workers' compensation claims (Continued)**

or fatalities, we maintain excess workers' compensation insurance (through our wholly owned captive insurance company, Associated Insurance Company for Excess (AICE)) with a per occurrence retention of \$5.0 million, except in Maryland and Colorado, where our per occurrence retention is \$1.0 million. AICE maintains excess workers' compensation insurance coverage with AIG between \$5.0 million and \$15.0 million per occurrence, except in Maryland and Colorado, where coverage with AIG is between \$1.0 million and \$25.0 million per occurrence. AIG's exposure to subprime mortgage securities and recent disruptions in the U.S. financial markets has adversely impacted AIG. However, AIG's commercial insurance subsidiary continues to be a fully accepted insurance carrier for all major brokers. As a result, we do not expect these developments to have a material impact on our insurance coverage with AIG. However, we will continue to evaluate the financial capacity of our insurers to assess the recoverability of the related insurer receivables.

The Company has provided a total of \$27.6 million and \$15.1 million at June 30, 2009 and December 31, 2008, respectively, as an estimated future liability for unsettled workers' compensation claims liabilities. Included in the foregoing liabilities are insured claims that will be paid by the Company's former excess workers' compensation insurer and for which the Company has reported a receivable from the insurer for the insured claims liability. Insured claims totaled \$2.6 million and \$2.7 million at June 30, 2009 and December 31, 2008, respectively. The estimated liability for unsettled workers' compensation claims represents management's best estimate based upon an actuarial valuation provided by a third party actuary. Included in the claims liabilities are case reserve estimates for reported losses, plus additional amounts based on projections for incurred but not reported claims and anticipated increases in case reserve estimates. These estimates are continually reviewed and adjustments to liabilities are reflected in current operating results as they become known.

During the second quarter of 2009, the Company engaged a new actuary to review its workers' compensation liabilities. While the Company has historically obtained an actuarial study, management has determined the study was not the best estimate of the workers' compensation liability. Based upon discussions with the new actuary and a thorough review of the Company's reserving process and consideration of recent developments, management has determined the actuarial estimate as of June 30, 2009 is the best estimate of the ultimate cost to settle open claims. Our primary considerations included the significant erosion in the economy, the increasing complexity and uncertainty surrounding healthcare costs, unexpected development in open claims and growth in our business. The change in estimate resulted in the Company increasing its workers' compensation claims liabilities by approximately \$11.8 million at June 30, 2009.

**Safety incentives liability**

Safety incentives represent cash incentives paid to certain PEO client companies for maintaining safe-work practices in order to minimize workplace injuries, thereby meeting certain established loss objectives. The Company has provided \$4.6 million at June 30, 2009 and December 31, 2008, respectively, as an estimate of the liability for unpaid safety incentives. The incentive is based on a percentage of annual payroll and is paid annually to customers who meet predetermined workers' compensation claims cost objectives. Safety incentive payments

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (*Continued*)

**Note 1 - Basis of Presentation of Interim Period Statements (Continued)**

**Safety incentives liability (Continued)**

are made only after closure of all workers' compensation claims incurred during the customer's contract period. The liability is estimated and accrued each month based upon the incentive earned less the then-current amount of the customer's estimated workers' compensation claims reserves as established by the Company's internal and third-party claims administrators, adjusted for expected future development of claims reserves.

**Comprehensive income (loss)**

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to a company's stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under GAAP are included in comprehensive income (loss), but are excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity. The Company's other comprehensive income (loss) is comprised of unrealized holding gains and losses on its publicly traded marketable securities designated as available-for-sale, net of realized gains or losses included in net income.

**Subsequent Events**

We have evaluated events and transactions occurring after the balance sheet date through August 10, 2009, which is the date that the financial statements are issued, and noted no events that are subject to recognition or disclosure.

**Note 2 - Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years for financial assets and liabilities. The effective date of the provisions of SFAS 157 for non-financial assets and liabilities, except for items recognized at fair value on a recurring basis, was deferred by the FASB Staff Position SFAS 157-2 and are effective for fiscal years beginning after November 15, 2008. The adoption of SFAS 157 for both financial and non-financial assets and liabilities has not had a material effect on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R) Business Combinations, (SFAS 141(R)). SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 141(R) has not had a material effect on our consolidated financial statements.

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 2 - Recent Accounting Pronouncements (Continued)**

In May 2009, the FASB issued Statement No. 165, Subsequent Events ( SFAS 165 ). SFAS 165 requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. We adopted SFAS 165 effective for the second quarter of 2009. See Note 1 for the disclosure.

In June 2009, the FASB issued SFAS No. 168 The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162 ( SFAS 168 ). SFAS 168 provides for the FASB Accounting Standards Codification (Codification) to become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of SFAS 168, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We believe the adoption of SFAS 168 will not have a material effect on our consolidated financial statements.

**Note 3 - Acquisitions**

Effective February 4, 2008, the Company acquired certain assets of First Employment Services, Inc., a privately held staffing company with offices in Tempe and Phoenix, Arizona. The Company paid \$3.8 million in cash upon closing and agreed to pay additional consideration of \$1.2 million in cash contingent upon the first 12 months of financial performance. Management completed the evaluation of the financial performance criteria for the 12-month period during the first quarter of 2009 and determined no additional consideration was due. The transaction resulted in the recognition of \$3.8 million of goodwill, \$15,000 of other assets and \$15,000 of fixed assets. The Company's consolidated income statements for the six months ended June 30, 2008 include First Employment's results of operations since February 4, 2008.

**Note 4 - Basic and Diluted Earnings Per Share**

Basic earnings per share are computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential effects of the exercise of outstanding stock options. Basic and diluted shares outstanding are summarized as follows:

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## BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 4 - Basic and Diluted Earnings Per Share (Continued)**

|   | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2009                           | 2008       | 2009                         | 2008       |
| Weighted average number of basic shares outstanding   | 10,354,765                     | 10,936,871 | 10,425,643                   | 11,011,865 |
| Stock option plan shares to be issued at prices ranging from \$2.00 to \$17.50 per share  |                                | 670,014    |                              | 686,840    |
| 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 |                                | (386,049)  |                              | (376,549)  |
| Weighted average number of diluted shares outstanding   | 10,354,765                     | 11,220,836 | 10,425,643                   | 11,322,156 |

As a result of the net loss reported for the three months and six months ended June 30, 2009, 191,856 and 191,656, respectively, of potential common shares have been excluded from the calculation of diluted loss per share because their effect would be anti-dilutive.

**Note 5 - Stock Incentive Plans and Stock-Based Compensation**

The Company's 2009 Stock Incentive Plan (the 2009 Plan), which provides for stock-based awards to Company employees, non-employee directors and outside consultants or advisors, was approved by shareholders on May 13, 2009. No options have been issued under the 2009 Plan. The number of shares of common stock reserved for issuance under the 2009 Plan is 1,000,000, of which the aggregate number of shares for which incentive stock options may be granted under the Plan is 900,000. No new grants of stock options may be made under the Company's 2003 Stock Incentive Plan (the 2003 Plan). At June 30, 2009, there were option awards covering 571,319 shares outstanding under the 2003 Plan and its predecessor, the 1993 Stock Incentive Plan. Outstanding options under both plans generally expire ten years after the date of grant. Options are generally exercisable in four equal annual installments beginning one year after the date of grant.

The Company applies SFAS No. 123R, Share-Based Payment (SFAS 123R), to account for compensation expense for options awarded under its stock incentive plans. SFAS 123R requires the grant-date fair value of all share-based payment awards, including employee



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## BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 5 - Stock Incentive Plans and Stock-Based Compensation (Continued)**

stock options, to be recognized as employee compensation expense over the requisite service period.

The following table summarizes options activity in 2009:

|                                      | Number<br>of Options | Grant Prices |    |          |
|--------------------------------------|----------------------|--------------|----|----------|
| Outstanding at December 31, 2008     | 501,006              | \$ 2.00      | to | \$ 17.50 |
| Options granted                      | 79,500               | \$ 10.74     | to | \$ 11.08 |
| Options exercised                    | (9,187)              | \$ 2.01      | to | \$ 2.58  |
| Options cancelled or expired         |                      |              |    |          |
| <br>                                 |                      |              |    |          |
| Outstanding at June 30, 2009         | 571,319              | \$ 2.00      | to | \$ 17.50 |
| <br>                                 |                      |              |    |          |
| Exercisable at June 30, 2009         | 484,319              |              |    |          |
| <br>                                 |                      |              |    |          |
| Available for grant at June 30, 2009 | 1,000,000            |              |    |          |

The following table presents information on stock options outstanding for the periods shown:

| (\$ in thousands, except per share data)           | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |          |
|--|--------------------------------|--------|------------------------------|----------|
|  | 2009                           | 2008   | 2009                         | 2008     |
| Intrinsic value of options exercised in the period | \$ 35                          | \$ 998 | \$ 68                        | \$ 1,056 |

|  | As of June 30, |            |
|--|----------------|------------|
|  | 2009           | 2008       |
| Stock options:                                 |                |            |
| Number of options                              | 571,319        | 571,318    |
| Options fully vested and currently exercisable | 484,319        | 561,318    |
| Weighted average exercise price                | \$ 7.65        | \$ 7.86    |
| Aggregate intrinsic value                      | \$ 2,294       | \$ 3,038   |
| Weighted average contractual term of options   | 5.25 years     | 5.57 years |

The aggregate intrinsic value of stock options represents the difference between the Company's closing stock price at the end of the period and the relevant exercise price multiplied by the number of options outstanding at the end of the period at each such price.

Stock-based compensation expense recognized under SFAS 123R for the three months ended June 30, 2009 and 2008 was \$25,000 and \$0, respectively, and for the six months ended June 30, 2009 and 2008, was \$50,000 and \$0, respectively.

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## BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 5 - Stock Incentive Plans and Stock-Based Compensation (Continued)**

The fair value of the stock-based awards, as determined under the Black-Scholes model, granted in the three months ended March 31, 2009 of \$349,000 or \$4.39 per share, was estimated with the following weighted-average assumptions:

|                           | <b>Three Months Ended<br/>March 31, 2009</b> |
|---------------------------|--|
| Stock options:            |  |
| Risk-free interest rate   | 1.36%  |
| Expected dividend yield   | 2.93%  |
| Expected term             | 7.1 years                                    |
| Expected volatility       | 61.94%                                       |
| Estimated forfeiture rate | 4.24%  |

There were no stock-based awards granted during the quarter ended June 30, 2009.

The following table summarizes stock-based compensation expense related to stock option awards under SFAS 123R for the six months ended June 30, 2009 and 2008 (in thousands):

|   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--|-------------|--------------------------------------|-------------|
|   | <b>2009</b>                            | <b>2008</b> | <b>2009</b>                          | <b>2008</b> |
| Stock-based compensation expense included in selling, general and administrative expenses | \$ 25                                  | \$ 50       | \$ 50                                | \$ 50       |
| Income tax benefit related to stock-based compensation                                    | 10                                     |             | 20                                   |             |
| Stock-based compensation expense related to stock options, net of tax                     | \$ 15                                  | \$ 50       | \$ 30                                | \$ 50       |

As of June 30, 2009, unamortized compensation expense related to stock options was \$342,000.

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## BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 6 - Workers Compensation**

The following table summarizes the aggregate workers compensation reserve activity (in thousands):

|   | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30,           |           | June 30,         |           |
|   | 2009               | 2008      | 2009             | 2008      |
| Beginning balance                       |                    |           |                  |           |
| Workers compensation claims liabilities | \$ 15,739          | \$ 13,118 | \$ 15,084        | \$ 12,741 |
| Add: claims expense accrual             | 15,236             | 4,456     | 18,655           | 7,994     |
| Less: claim payments related to:        |                    |           |                  |           |
| Current year                            | 611                | 736       | 711              | 894       |
| Prior years                             | 2,807              | 2,278     | 5,471            | 5,281     |
| Total paid                              | 3,418              | 3,014     | 6,182            | 6,175     |
| Ending balance                          |                    |           |                  |           |
| Workers compensation claims liabilities | \$ 27,557          | \$ 14,560 | \$ 27,557        | \$ 14,560 |
| Incurred but not reported (IBNR)        | \$ 17,011          | \$ 5,918  | \$ 17,011        | \$ 5,918  |

During the second quarter of 2009, the Company engaged a new actuary to review its workers compensation liabilities. While the Company has historically obtained an actuarial study, management has determined the study was not the best estimate of the workers compensation liability. Based upon discussions with the new actuary and a thorough review of the Company's reserving process and consideration of recent developments, management has determined the actuarial estimate as of June 30, 2009 is the best estimate of the ultimate cost to settle open claims. Our primary considerations included the significant erosion in the economy, the increasing complexity and uncertainty surrounding healthcare costs, unexpected development in open claims and growth in our business. The change in estimate resulted in the Company increasing its workers compensation claims liabilities by approximately \$11.8 million at June 30, 2009.

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## BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 7 - Fair Value Measurement**

The Company has determined that its marketable securities should be presented at their fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company has determined that its closed-end bond funds, U.S. treasuries and equity securities components of its marketable securities fall into the Level 1 category, which values assets at the quoted prices in active markets for the same identical assets. The Company has also determined its municipal bonds, VRDN and corporate bonds components fall into the Level 2 category, which values assets using inputs other than quoted prices that are observable for the asset either directly or indirectly. There were no assets or liabilities where Level 3 valuation techniques were used and there were no assets and liabilities measured at fair value on a non-recurring basis.

Marketable securities consist of the following investments (in thousands):

|                            | June 30, 2009 |            |           | December 31, 2008 |            |           |
|----------------------------|---------------|------------|-----------|-------------------|------------|-----------|
|                            | Cost          | Gross      | Recorded  | Cost              | Gross      | Recorded  |
|                            | Basis         | Unrealized | Basis     | Basis             | Unrealized | Basis     |
|                            |               | Gains      |           |                   | (Losses)   |           |
|                            |               | (Losses)   |           |                   |            |           |
| <b>Current:</b>            |               |            |           |                   |            |           |
| <b>Trading:</b>            |               |            |           |                   |            |           |
| Equity securities          | \$ 349        | \$ (172)   | \$ 177    | \$ 349            | \$ (92)    | \$ 257    |
| <b>Available-for-sale:</b> |               |            |           |                   |            |           |
| Municipal bonds            | 11,289        | 35         | 11,324    | 16,704            | 55         | 16,759    |
| Variable rate demand notes | 400           |            | 400       | 401               |            | 401       |
| Closed-end bond funds      | 491           | 221        | 712       | 491               | 60         | 551       |
| U.S. treasuries            | 501           |            | 501       |                   |            |           |
|                            | \$ 13,030     | \$ 84      | \$ 13,114 | \$ 17,945         | \$ 23      | \$ 17,968 |
| <b>Long term:</b>          |               |            |           |                   |            |           |
| <b>Available-for-sale:</b> |               |            |           |                   |            |           |
| Corporate bonds            | \$ 10,752     | \$         | \$ 10,752 | \$                | \$         | \$        |
| <b>Held-to-maturity:</b>   |               |            |           |                   |            |           |
| Corporate bonds            | 432           |            | 432       | 427               |            | 427       |
|                            | \$ 11,184     | \$         | \$ 11,184 | \$ 427            |            | 427       |

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

#### **Overview**

Barrett Business Services, Inc. ( Barrett , the Company or we ), a Maryland corporation, offers a comprehensive range of human resource management services to help small and medium-sized businesses manage the increasing costs and complexities of a broad array of employment-related issues. The Company's principal services, professional employer organization ( PEO ) services and staffing services, assist its clients in leveraging their investment in human capital. The Company believes that the combination of these two principal services enables it to provide clients with a unique blend of services not offered by the Company's competition. Barrett's platform of outsourced human resource management services is built upon expertise in payroll processing, employee benefits and administration, workers' compensation coverage, effective risk management and workplace safety programs, and human resource administration.

To provide PEO services to a client, the Company enters into a contract to become a co-employer of the client's existing workforce and Barrett assumes responsibility for some or all of the client's human resource management responsibilities. PEO services are normally used by organizations to satisfy ongoing human resource management needs and typically involve contracts with a minimum term of one year, renewable annually, which cover all employees at a particular work site. Staffing services include on-demand or short-term staffing assignments, long-term or indefinite-term contract staffing and comprehensive on-site management. The Company's staffing services also include direct placement services, which involve fee-based search efforts for specific employee candidates at the request of PEO clients, staffing customers or other companies.

The Company's ability to offer clients a broad mix of services allows Barrett to effectively become the human resource department and a strategic business partner for its clients. The Company believes its approach to human resource management services is designed to positively affect its clients' business results by:

allowing clients to focus on core business activities instead of human resource matters;

increasing clients' productivity by improving employee satisfaction and generating greater employee retention;

reducing overall payroll expenses due to lower workers' compensation and health insurance costs; and

assisting clients in complying with complex and evolving human resource-related regulatory and tax issues.

The Company serves a growing and diverse client base of small and medium-sized businesses in a wide variety of industries through a network of branch offices in California, Oregon, Washington, Idaho, Arizona, Utah, Colorado, Maryland, Delaware and North Carolina. Barrett also has several smaller recruiting offices in its general market areas, which are under the direction of a branch office.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Results of Operations**

The following table sets forth a percentages of total revenues represented by selected items in the Company's Consolidated Statements of Operations for the three and six months ended June 30, 2009 and 2008.

|  | Percentage of Total Revenues |              |                  |              |
|--|------------------------------|--------------|------------------|--------------|
|  | Three Months Ended           |              | Six Months Ended |              |
|  | June 30,<br>2009             | 2008         | June 30,<br>2009 | 2008         |
| <b>Revenues:</b>                             |                              |              |                  |              |
| Staffing services                            | 48.9%                        | 56.3%        | 48.0%            | 55.2%        |
| Professional employer service fees           | 51.1                         | 43.7         | 52.0             | 44.8         |
| <b>Total revenues</b>                        | <b>100.0</b>                 | <b>100.0</b> | <b>100.0</b>     | <b>100.0</b> |
| <b>Cost of revenues:</b>                     |                              |              |                  |              |
| Direct payroll costs                         | 36.9                         | 41.5         | 36.2             | 40.7         |
| Payroll taxes and benefits                   | 33.9                         | 28.7         | 38.8             | 32.7         |
| Workers' compensation                        | 33.1                         | 10.3         | 23.6             | 10.3         |
| <b>Total cost of revenues</b>                | <b>103.9</b>                 | <b>80.5</b>  | <b>98.6</b>      | <b>83.7</b>  |
| <b>Gross margin</b>                          | <b>(3.9)</b>                 | <b>19.5</b>  | <b>1.4</b>       | <b>16.3</b>  |
| Selling, general and administrative expenses | 14.6                         | 12.7         | 15.1             | 12.9         |
| Depreciation and amortization                | 0.7                          | 0.5          | 0.7              | 0.5          |
| <b>(Loss) income from operations</b>         | <b>(19.2)</b>                | <b>6.3</b>   | <b>(14.4)</b>    | <b>2.9</b>   |
| Other income                                 | 0.5                          | 0.8          | 0.3              | 0.9          |
| <b>(Loss) income before taxes</b>            | <b>(18.7)</b>                | <b>7.1</b>   | <b>(14.1)</b>    | <b>3.8</b>   |
| (Benefit from) provision for income taxes    | (6.9)                        | 2.6          | (5.0)            | 1.4          |
| <b>Net (loss) income</b>                     | <b>(11.8)%</b>               | <b>4.5%</b>  | <b>(9.1)%</b>    | <b>2.4%</b>  |

We report PEO revenues in accordance with the requirements of Emerging Issues Task Force No. 99-19, "Reporting Revenues Gross as a Principal Versus Net as an Agent" (EITF No. 99-19), which requires us to report such revenues on a net basis because we are not the primary obligor for the services provided by our PEO clients to their customers pursuant to our PEO contracts. We present for comparison purposes the gross revenues and cost of revenues information set forth in the table below. Although not in accordance with GAAP, management believes this information is more informative as to the level of our business activity and more illustrative of how we manage our operations, including the preparation of our internal operating forecasts, because it presents our PEO services on a basis comparable to our staffing services.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**  
**Results of Operations (Continued)**

The presentation of revenues on a net basis and the relative contributions of staffing and PEO revenues can create volatility in our gross margin percentage. The general impact of fluctuations in our revenue mix is described below.

A relative increase in staffing revenues will typically result in a lower gross margin percentage. Staffing revenues are presented at gross with the related direct costs reported in cost of sales. While staffing relationships typically have higher margins than PEO relationships, an increase in staffing revenues and related costs presented at gross dilutes the impact of the net PEO revenue on gross margin percentage.

A relative increase in PEO revenue will result in a higher gross margin percentage. Improvement in gross margin percentage occurs because incremental PEO revenue dollars are reported as revenue net of all related direct costs.

| (in thousands)                 | Unaudited<br>Three Months Ended<br>June 30, |           | Unaudited<br>Six Months Ended<br>June 30, |           |
|--------------------------------|---|-----------|---|-----------|
|                                | 2009  | 2008      | 2009                                      | 2008      |
| <b>Revenues:</b>               |   |           |   |           |
| Staffing services              | \$ 28,002                                   | \$ 40,604 | \$ 52,044                                 | \$ 76,423 |
| Professional employer services | 220,150                                     | 228,891   | 423,975                                   | 452,652   |
| Total revenues                 | 248,152                                     | 269,495   | 476,019                                   | 529,075   |
| <b>Cost of revenues:</b>       |   |           |   |           |
| Direct payroll costs           | 210,720                                     | 225,887   | 404,276                                   | 443,740   |
| Payroll taxes and benefits     | 19,434                                      | 20,721    | 42,061                                    | 45,166    |
| Workers' compensation          | 20,221                                      | 8,833     | 28,216                                    | 17,553    |
| Total cost of revenues         | 250,375                                     | 255,441   | 474,553                                   | 506,459   |
| Gross margin                   | \$ (2,223)                                  | \$ 14,054 | \$ 1,466                                  | \$ 22,616 |

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**  
**Results of Operations (Continued)**

A reconciliation of non-GAAP gross PEO revenues to net PEO revenues is as follows:

| (in thousands)                 | Unaudited<br>Three Months Ended June 30, |            |                  |              |                                 |           |
|--------------------------------|--|------------|------------------|--------------|---------------------------------|-----------|
|                                | Gross Revenue<br>Reporting Method        |            | Reclassification |              | Net Revenue<br>Reporting Method |           |
|                                | 2009                                     | 2008       | 2009             | 2008         | 2009                            | 2008      |
| Revenues:                      |  |            |                  |              |                                 |           |
| Staffing services              | \$ 28,002                                | \$ 40,604  | \$               | \$           | \$ 28,002                       | \$ 40,604 |
| Professional employer services | 220,150                                  | 228,891    | (190,887)        | (197,312)    | 29,263                          | 31,579    |
| Total revenues                 | \$ 248,152                               | \$ 269,495 | \$ (190,887)     | \$ (197,312) | \$ 57,265                       | \$ 72,183 |
| Cost of revenues               | \$ 250,375                               | \$ 255,441 | \$ (190,887)     | \$ (197,312) | \$ 59,488                       | \$ 58,129 |

| (in thousands)                 | Unaudited<br>Six Months Ended June 30, |            |                  |              |                                 |            |
|--------------------------------|--|------------|------------------|--------------|---------------------------------|------------|
|                                | Gross Revenue<br>Reporting Method      |            | Reclassification |              | Net Revenue<br>Reporting Method |            |
|                                | 2009                                   | 2008       | 2009             | 2008         | 2009                            | 2008       |
| Revenues:                      |  |            |                  |              |                                 |            |
| Staffing services              | \$ 52,044                              | \$ 76,423  | \$               | \$           | \$ 52,044                       | \$ 76,423  |
| Professional employer services | 423,975                                | 452,652    | (367,682)        | (390,698)    | 56,293                          | 61,954     |
| Total revenues                 | \$ 476,019                             | \$ 529,075 | \$ (367,682)     | \$ (390,698) | \$ 108,337                      | \$ 138,377 |
| Cost of revenues               | \$ 474,553                             | \$ 506,459 | \$ (367,682)     | \$ (390,698) | \$ 106,871                      | \$ 115,761 |

The amount of the reclassification is comprised of direct payroll costs and safety incentives attributable to our PEO client companies.

**Three months ended June 30, 2009 and 2008**

Net loss for the second quarter of 2009 amounted to \$6.7 million, a decline of \$10.0 million from net income of \$3.3 million for the second quarter of 2008. The decline for the second quarter of 2009 was primarily due to lower revenues and lower gross margin dollars primarily resulting from an \$11.8 million increase in worker compensation expense due to the Company's change in estimate of its workers' compensation claims liabilities as of June 30, 2009. Diluted loss per share for the second quarter of 2009 was \$.65 compared to a diluted earnings per share of \$.29 for the comparable 2008 period.



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**  
**Results of Operations (Continued)**

*Three months ended June 30, 2009 and 2008 (Continued)*

Revenues for the second quarter of 2009 totaled \$57.3 million, a decrease of approximately \$14.9 million or 20.7%, which reflects a decrease in both the Company's staffing service revenue and PEO service fee revenue. Staffing services revenue decreased approximately \$12.6 million or 31.0% due to a continued decline in demand for our staffing services from existing customers in the majority of our markets. Management expects demand for the Company's staffing services will continue to reflect overall economic conditions in its market areas. PEO service fee revenue decreased approximately \$2.3 million or 7.3% from the comparable 2008 quarter. While our PEO business from new customers during the second quarter of 2008 exceeded our loss of PEO business from former customers, the overall decline in PEO business resulted from decreased hours worked at existing PEO customer worksites.

Gross margin for the second quarter of 2009 represented a loss of approximately \$2.2 million, or a decrease of \$16.3 million from the second quarter of 2008, primarily due to the \$11.8 million additional workers' compensation expense adjustment, a 20.7% decline in revenues and higher payroll taxes and benefits as a percentage of revenues. The increase in payroll taxes and benefits, as a percentage of revenues, from 28.7% for the second quarter of 2008 to 33.9% for the second quarter of 2009, was principally due to higher statutory state unemployment tax rates in various states in which the Company operates as compared to the second quarter of 2008 as well as to an increase in business mix of PEO services where payroll taxes and benefits are presented at gross cost whereas the related direct payroll costs are netted against PEO services revenue.

During the second quarter of 2009, the Company engaged a new actuary to review its workers' compensation liabilities. While the Company has historically obtained an actuarial study, management has determined the study was not the best estimate of the workers' compensation liability. Based upon discussions with the new actuary and a thorough review of the Company's reserving process and consideration of recent developments, management has determined the actuarial estimate as of June 30, 2009 is the best estimate of the ultimate cost to settle open claims. Our primary considerations included the significant erosion in the economy, the increasing complexity and uncertainty surrounding healthcare costs, unexpected development in open claims and growth in our business. The change in estimate resulted in the Company increasing its workers' compensation claims liabilities by approximately \$11.8 million at June 30, 2009.

Workers' compensation expense, as a percent of revenues, increased from 10.3% in the second quarter of 2008 to 33.1% in the second quarter of 2009. Workers' compensation expense for the second quarter of 2009 totaled \$18.9 million, compared to \$7.5 million for the second quarter of 2008. The increase in the expense as a percentage of revenues was primarily due to the \$11.8 million additional workers' compensation expense adjustment.

The decrease in direct payroll costs, as a percentage of revenues, from 41.5% for the second quarter of 2008 to 36.9% for the second quarter of 2009 was largely due to the significant decline in staffing services business.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

**Results of Operations (Continued)**

Selling, general and administrative (SG&A) expenses for the second quarter of 2009 amounted to approximately \$8.3 million, a decline of \$829,000 or 9.0% from the second quarter of 2008. The decrease from the second quarter of 2008 was primarily attributable to lower branch management payroll, profit sharing and commissions due to the decline in business activity and profitability.

Other income for the second quarter of 2009 was \$293,000 compared to other income of \$587,000 for the second quarter of 2008. The decline in other income for the second quarter of 2009 was primarily attributable to decreased investment income earned on the Company's cash and investments resulting from a significant decline in investment yields compared to the 2008 second quarter.

***Six months ended June 30, 2009 and 2008***

Net loss for the six months ended June 30, 2009 amounted to \$9.9 million, a decline of \$13.2 million from net income of \$3.3 million for the comparable period of 2008. The decline for the six months ended June 30, 2009 was primarily due to lower revenues and lower gross margin dollars principally due to an \$11.8 million increase in workers' compensation expense resulting from the Company's change in estimate of its workers' compensation reserves during the second quarter of 2009. Diluted loss per share for the first six months of 2009 was \$.95 compared to diluted earnings per share of \$.30 for the comparable 2008 period.

Revenues for the six months ended June 30, 2009 totaled \$108.3 million, a decrease of approximately \$30.0 million or 21.7%, which reflects a decrease in both the Company's staffing service revenue and PEO service fee revenue. Staffing services revenue decreased approximately \$24.4 million or 31.9% due to a significant decline in demand for our staffing services from existing customers in the majority of our markets. PEO service fee revenue decreased approximately \$5.6 million or 9.1% from the comparable 2008 period primarily due to a decline in business as a result of decreased hours worked at existing PEO customer worksites, partially offset by the net effect of the addition of new customers.

Gross margin for the six months ended June 30, 2009 totaled approximately \$1.5 million, which represented a decrease of \$21.2 million from the comparable period of 2008, primarily due to the \$11.8 million additional workers' compensation expense adjustment, a 21.7% decline in revenues and higher payroll taxes and benefits as a percentage of revenues. The gross margin percent decreased from 16.3% of revenues for the first six months of 2008 to 1.4% for the first six months of 2009. The increase in payroll taxes and benefits, as a percentage of revenues, from 32.7% for the first six months of 2008 to 38.8% for the first six months of 2009, was principally due to higher statutory state unemployment tax rates in various states in which the Company operates in 2009 as compared to 2008.

Workers' compensation expense, as a percent of revenues, increased from 10.3% in the first six months of 2008 to 23.6% in the first six months of 2009. Workers' compensation expense for the first six months of 2009 totaled \$25.6 million, compared to \$14.3 million for the first six months of 2008. The increase in the expense as a percentage of revenues was primarily due to the \$11.8 million additional workers' compensation expense adjustment. The decrease in direct payroll costs, as a percentage of revenues, from 40.7% for the first six months of 2008 to 36.2% for the first six months of 2009 was largely due to the significant decline in staffing services business.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**  
**Results of Operations (Continued)**

*Six months ended June 30, 2009 and 2008 (Continued)*

SG&A expenses for the first six months of 2009 amounted to approximately \$16.4 million, a decline of \$1.5 million or 8.2% from the first six months of 2008. The decrease from the first six months of 2008 was primarily attributable to lower branch management payroll, lower profit sharing and an overall reduction in variable operating expenses due to the decline in business activity.

Other income for the first six months of 2009 was \$408,000 compared to other income of \$1.2 million for the comparable period of 2008. The decline in other income for the first six months of 2009 was primarily attributable to decreased investment income earned on the Company's cash and investments resulting from a significant decline in investment yields.

**Factors Affecting Quarterly 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 statutory payroll taxes, claims experience for workers' compensation, demand and competition for the Company's services and the effect of acquisitions. The Company's revenue levels may fluctuate from quarter to quarter primarily due to the impact of seasonality on its staffing services business and on certain of its PEO clients in the agriculture, food processing and construction-related industries. As a result, the Company may have greater revenues and net income in the third quarter of its fiscal year. Revenue levels in the fourth quarter may be affected by many customers' practice of operating on holiday-shortened schedules. Payroll taxes and benefits fluctuate with the level of direct payroll costs, but tend to represent a smaller percentage of revenues and direct payroll later in the Company's fiscal year as federal and state statutory wage limits for unemployment and social security taxes are exceeded on a per employee basis. Workers' compensation expense varies with both the frequency and severity of workplace injury claims reported during a quarter and the estimated future costs of such claims. Adverse loss development of prior period claims during a subsequent quarter may also contribute to the volatility in the Company's estimated workers' compensation expense.

**Liquidity and Capital Resources**

The Company's cash position for the six months ended June 30, 2009 decreased \$15.1 million from December 31, 2008, which compares to an increase of \$6.9 million for the comparable period in 2008. The decrease in cash at June 30, 2009 as compared to December 31, 2008, was primarily due to purchases of marketable securities of \$14.0 million, and a net loss from operating activities of \$9.9 million, offset in part by proceeds from sales and maturities of marketable securities of \$8.2 million.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

**Liquidity and Capital Resources (Continued)**

Net cash used in operating activities for the six months ended June 30, 2009 amounted to \$4.3 million, compared to cash provided by operating activities of \$736,000 for the comparable 2008 period. For the six months ended June 30, 2009, cash flow was principally used by a \$9.9 million net loss, an increase in trade accounts receivable of \$7.1 million, and an increase in deferred income taxes and income taxes receivable totaling \$5.5 million, offset in part by an increase in workers' compensation claims liabilities of \$12.7 million and an increase in accrued payroll, payroll taxes and related benefits of \$6.6 million.

Net cash used in investing activities totaled \$7.0 million for the six months ended June 30, 2009 compared to cash provided by investing activities of \$11.6 million for the similar 2008 period. For the 2009 period, cash from investing activities was principally used in the purchase of marketable securities totaling \$14.0 million, offset in part by the proceeds from the sales and maturities of marketable securities of \$8.2 million. The transactions related to restricted marketable securities were scheduled maturities and the related replacement of such securities held for workers' compensation surety deposit purposes. The Company presently has no material long-term capital commitments.

Net cash used in financing activities for the six-month period ended June 30, 2009, was \$3.8 million as compared to \$5.5 million for the similar 2008 period. For the 2009 period, the principal use of cash for financing activities was the Company's repurchase of 235,800 shares of its common stock for \$2.2 million under the approved repurchase program and the payment of regular quarterly cash dividends totaling \$1.7 million to holders of the Company's Common Stock.

As disclosed in Note 3 to the consolidated financial statements in this report, the Company acquired certain assets of First Employment Services, Inc., a privately held staffing services company with offices in Tempe and Phoenix, Arizona, effective February 4, 2008. As consideration for the acquisition, the Company paid \$3.8 million in cash and agreed to pay additional consideration of \$1.2 million contingent upon the first 12 months of financial performance. Management completed the evaluation of the financial performance criteria for the 12-month period during the first quarter of 2009 and determined no additional consideration was due.

The Company's business strategy continues to focus on growth through the expansion of operations at existing offices, together with the selective acquisition of additional personnel-related business, both in its existing markets and other strategic geographic markets. The Company periodically evaluates proposals for various acquisition opportunities, but there can be no assurance that any additional transactions will be consummated.

Effective May 27, 2009, the Company chose to eliminate its line of credit with its principal bank and subsequently amended its credit agreement with the bank. The Standby Letter of Credit Agreement dated as of June 30, 2009 (the "Credit Agreement") provides for standby letters of credit as to which there were \$6.7 million outstanding at June 30, 2009 in connection with various surety deposit requirements for workers' compensation purposes.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

#### Liquidity and Capital Resources (Continued)

Pursuant to the Credit Agreement, the Company is required to maintain compliance with the following covenants: (1) to incur a net loss after taxes of no more than \$8.0 million for the year ending December 31, 2009 and maintain net income after taxes not less than \$1.00 (one dollar) on an annual basis thereafter, determined as of each fiscal year end; (2) to maintain liquid assets (defined as unencumbered cash, cash equivalents, and publicly traded and quoted marketable securities) having an aggregate fair market value at all times not less than \$10.0 million, determined as of the end of each fiscal quarter; and (3) to not borrow or permit to exist indebtedness (other than from or to the bank), or mortgage, pledge, grant, or permit to exist a security interest in, or a lien upon, all or any portion of the Company's assets now owned or hereafter acquired, except for purchase money indebtedness (and related security interests) which does not at any time exceed \$500,000.

Management expects that current liquid assets and the funds anticipated to be generated from operations will be sufficient in the aggregate to fund the Company's working capital needs for the next twelve months.

#### 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 and effect on revenue levels, the potential for and effect of past and 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 the effect of changes in estimate of its claims liabilities, the adequacy of the Company's allowance for doubtful accounts, the effect of the Company's formation of a wholly owned, fully licensed captive insurance subsidiary and becoming self-insured for certain business risks, the effectiveness of the Company's management information systems, payment of future dividends, and the availability of 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 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, material deviations from expected future workers' compensation claims experience, the effect of changes in the workers' compensation regulatory environment in one or more of the Company's primary markets, collectibility of accounts receivable, the carrying values of deferred income tax assets and goodwill, which may be affected by the Company's future operating results, the availability of capital or letters of credit necessary to meet state-mandated surety deposit requirements for

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**  
**Forward-Looking Information (Continued)**

maintaining the Company's status as a qualified self-insured employer for workers' compensation coverage, and the use of \$40.3 million in cash and current marketable securities, among others. 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.

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

The Company's exposure to market risk for changes in interest rates primarily relates to its investment portfolio of liquid assets. As of June 30, 2009, the Company's investment portfolio consisted principally of approximately \$26.8 million in tax-exempt money market funds, \$12.2 million in tax-exempt municipal bonds with an average maturity of 92 days, and approximately \$11.9 million in bond funds and corporate bonds. Based on the Company's overall interest exposure at June 30, 2009, a 100 basis point increase in market interest rates would not have a material effect on the fair value of the Company's investment portfolio of liquid assets or its results of operations because of the predominantly short maturities of the securities within the investment portfolio.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures**

The Company conducted an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of June 30, 2009, continued to be ineffective in providing a reasonable level of assurance that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, as a result of the material weakness identified as of December 31, 2006 and that continued to exist as of June 30, 2009, the nature of which is summarized below.

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**Item 4. Controls and Procedures (Continued)**

**Internal Control Over Financial Reporting**

In our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2008, a material weakness existed and is summarized as follows:

Our Company did not maintain effective controls over information technology ( IT ); specifically, general IT controls over program changes and program development were ineffectively designed and/or operating as of December 31, 2008. These aggregate deficiencies, along with their associated reflection on the control environment, resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim financial statements would not be prevented or detected.

In order to address the material weakness over program changes to our IT systems described above and to ensure that adequate personnel resources, independent oversight and documentation for financial reporting are in place, management initiated the following remedial action during 2008 and completed these priorities during the first quarter of 2009:

1. Application user acceptance testing.
2. Systematic testing of automated functionality.
3. Validation of data conversion and migration to the Company's upgraded financial system.
4. Formal authorization for deployment of the financial system upgrade.

In addition to implementing changes in our IT systems, we are evaluating our entity level controls and business application controls that will serve as compensating controls for the weaknesses in our IT controls.

Management completed a software upgrade to its primary financial application system in late March 2009 and continues to document, implement and test IT system controls related to areas described above. Management believes that these measures coupled with the identification and documentation of compensating entity level and business process controls, when fully tested, will mitigate the material weakness described above. Until testing is completed, however, we cannot yet conclude that any changes in our internal control over financial reporting occurred during the quarter ended June 30, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Audit Committee of the Board of Directors will continue to monitor the effectiveness of our internal controls and procedures on an ongoing basis and will instruct management to take further action as appropriate.

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## Part II - Other Information

**Item 1A. Risk Factors**

There have been no material changes in our risk factors from those disclosed in our 2008 Annual Report on Form 10-K.

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

In November 2006, the Board adopted a stock repurchase program and authorized the repurchase of up to 500,000 shares of the Company's stock from time to time in open market purchases. In November 2007, the Board approved an increase in the authorized shares to be repurchased up to 1.0 million shares. In October 2008, the Board approved a second increase in the authorized shares to be repurchased up to 3.0 million shares. The following table summarizes information related to stock repurchases during the quarter ended June 30, 2009.

| Month | Shares Repurchased | Average Price Per Share | Total Value of Shares Repurchased as Part of Publicly Announced Plan | Maximum Number of Shares that May Yet Be Repurchased Under the Plan |
|-------|--------------------|-------------------------|--|---|
| April | 2,100              | \$ 9.48                 | \$ 19,900  | 1,891,500   |
| May   |                    |                         |  |   |
| June  |                    |                         |  |   |
| Total | 2,100              |                         | \$ 19,900  |   |

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

The Company held its 2009 annual meeting of stockholders on May 13, 2009. The following directors were elected at the annual meeting:

|                       | For       | Withheld  | Exception |
|-----------------------|-----------|-----------|-----------|
| Thomas J. Carley      | 6,150,700 | 3,763,338 |           |
| James B. Hicks, Ph.D. | 6,151,111 | 3,762,927 |           |
| Roger L. Johnson      | 6,142,185 | 3,771,853 |           |
| Jon L. Justesen       | 8,222,188 | 1,691,850 |           |
| Anthony Meeker        | 6,150,764 | 3,763,274 |           |
| William W. Sherertz   | 9,543,806 | 370,232   |           |

The second matter presented for action at the annual meeting was approved by the following vote:

|   | For       | Against | Abstain |
|---|-----------|---------|---------|
| Approval of the 2009 Stock Incentive Plan | 7,500,411 | 255,738 | 11,179  |



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BARRETT BUSINESS SERVICES, INC.

**Item 5. Other Information**

At the 2009 annual meeting of stockholders on May 13, 2009, the Company's stockholders approved the 2009 Stock Incentive Plan (the Plan). The description of the Plan included under the heading "Item 2 - Approval of the 2009 Stock Incentive Plan" in the Company's Proxy Statement filed with the Securities and Exchange Commission April 10, 2009 is incorporated herein by reference. A copy of the Plan is attached to this report as Exhibit 10.2 and incorporated herein by reference. No awards have been granted under the Plan.

**Item 6. Exhibits**

The exhibits filed with this report are listed in the Exhibit Index following the signature page of this report.

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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: August 10, 2009

/s/ James D. Miller  
James D. Miller  
Vice President-Finance, Treasurer and Secretary  
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

**Exhibit**

- 10.1 Standby Letter of Credit Agreement dated as of June 30, 2009, between the Registrant and Wells Fargo Bank, N.A.
- 10.2 2009 Stock Incentive Plan of the Registrant.
- 31.1 Certification of the Chief Executive Officer under Rule 13a-14(a).
- 31.2 Certification of the Chief Financial Officer under Rule 13a-14(a).
- 32 Certification pursuant to 18 U.S.C. Section 1350.

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