

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended: **June 27, 2003**

or

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

Commission File Number: **001-14543**

**LABOR READY, INC.**

(Exact name of Registrant as specified in its charter)

**Washington**

(State or other jurisdiction of  
incorporation or organization)

**91-1287341**

(IRS Employer  
Identification No.)

**1015 A Street, Tacoma, Washington**

(Address of principal executive offices)

**98402**

(Zip Code)

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

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

**Title of each class**

Common Stock without par value

**Name of each exchange on which registered**

The New York Stock Exchange

Securities registered under Section 12(g) of the Act:

**Title of class**

None

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 last ninety days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of July 25, 2003, there were 40,222,633 shares of the Registrant's common stock outstanding.

Documents incorporated by reference: None.

**LABOR READY, INC.**

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**LABOR READY, INC.**  
**CONSOLIDATED BALANCE SHEETS**

In Thousands

ASSETS

(Unaudited)

|  | June 27,<br>2003 | December 31,<br>2002 |
|--|------------------|----------------------|
| <b>CURRENT ASSETS:</b>                                     |                  |                      |
| Cash and cash equivalents                                  | \$ 81,700        | \$ 69,255            |
| Marketable securities                                      | 29,031           | 21,322               |
| Accounts receivable  | 6,002            | 4,938                |
| Accounts receivable pledged under securitization agreement | 79,808           | 68,540               |
| Allowance for doubtful accounts                            | (4,662)          | (6,491)              |
| Prepaid expenses, deposits and other                       | 10,030           | 10,538               |
| Deferred income taxes                                      | 11,441           | 9,188                |
|  | <hr/>            | <hr/>                |
| Total current assets                                       | 213,350          | 177,290              |
| <b>PROPERTY AND EQUIPMENT:</b>                             |                  |                      |
| Buildings and land   | 15,642           | 15,536               |
| Computers and software                                     | 27,184           | 26,102               |
| Cash dispensing machines                                   | 14,731           | 14,214               |
| Furniture and equipment                                    | 1,798            | 1,625                |
|  | <hr/>            | <hr/>                |
|  | 59,355           | 57,477               |
| Less accumulated depreciation and amortization             | 30,398           | 26,260               |
|  | <hr/>            | <hr/>                |
| Property and equipment, net                                | 28,957           | 31,217               |
| <b>OTHER ASSETS:</b>                                       |                  |                      |
| Restricted cash and other assets                           | 69,359           | 95,311               |
| Deferred income taxes                                      | 14,649           | 9,425                |
| Other assets   | 3,546            | 3,957                |
|  | <hr/>            | <hr/>                |
| Total other assets   | 87,554           | 108,693              |
|  | <hr/>            | <hr/>                |
| Total assets   | \$ 329,861       | \$ 317,200           |

See accompanying notes to consolidated financial statements

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**LABOR READY, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**In Thousands (Except Par Values)**  
**LIABILITIES AND SHAREHOLDERS' EQUITY**  
**(Unaudited)**

|   | June 27,<br>2003  | December 31,<br>2002 |
|---|-------------------|----------------------|
| <b>CURRENT LIABILITIES:</b>   |                   |                      |
| Accounts payable  | \$ 12,139         | \$ 10,456            |
| Accrued wages and benefits  | 12,837            | 12,000               |
| Income tax payable  | 6,910             | 822                  |
| Current portion of workers' compensation claims reserve   | 31,126            | 32,215               |
| Current maturities of long-term debt  | 2,367             | 2,343                |
| <b>Total current liabilities</b>  | <b>65,379</b>     | <b>57,836</b>        |
| <b>LONG-TERM LIABILITIES:</b>   |                   |                      |
| Long-term debt, less current maturities   | 73,301            | 73,574               |
| Workers' compensation claims reserve  | 59,335            | 53,679               |
| <b>Total long-term liabilities</b>  | <b>132,636</b>    | <b>127,253</b>       |
| <b>Total liabilities</b>  | <b>198,015</b>    | <b>185,089</b>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                   |                      |
| <b>SHAREHOLDERS' EQUITY:</b>  |                   |                      |
| Preferred stock, \$0.131 par value, 20,000 shares authorized;<br>No shares issued and outstanding         | —                 | —                    |
| Common stock, no par value, 100,000 shares authorized;<br>40,215 and 40,773 shares issued and outstanding | 47,448            | 50,854               |
| Cumulative foreign currency translation adjustment  | 1,243             | 127                  |
| Cumulative unrealized gain on marketable securities   | 68                | 49                   |
| Retained earnings   | 83,087            | 81,081               |
| <b>Total shareholders' equity</b>   | <b>131,846</b>    | <b>132,111</b>       |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 329,861</b> | <b>\$ 317,200</b>    |

See accompanying notes to consolidated financial statements

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**LABOR READY, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

In Thousands (Except Per Share Data)

(Unaudited)

|  | Thirteen Weeks Ended |                  | Twenty-Six Weeks Ended |                  |
|--|----------------------|------------------|------------------------|------------------|
|  | June 27,<br>2003     | June 28,<br>2002 | June 27,<br>2003       | June 28,<br>2002 |
| Revenue from services                        | \$ 215,684           | \$ 219,100       | \$ 387,964             | \$ 389,208       |
| Cost of services                             | 150,710              | 156,141          | 272,093                | 277,487          |
| Gross profit                                 | 64,974               | 62,959           | 115,871                | 111,721          |
| Selling, general and administrative expenses | 53,868               | 54,347           | 106,587                | 106,629          |
| Depreciation and amortization                | 2,044                | 2,672            | 4,115                  | 4,791            |
| Income from operations                       | 9,062                | 5,940            | 5,169                  | 301              |
| Interest and other expense, net              | (1,020)              | (330)            | (2,082)                | (541)            |
| Income (loss) before tax expense (benefit)   | 8,042                | 5,610            | 3,087                  | (240)            |
| Income tax (benefit)                         | 2,821                | 2,160            | 1,081                  | (94)             |
| Net income (loss)                            | <b>\$ 5,221</b>      | <b>\$ 3,450</b>  | <b>\$ 2,006</b>        | <b>\$ (146)</b>  |
| Net income (loss) per common share:          |                      |                  |                        |                  |
| Basic  | \$ 0.13              | \$ 0.08          | \$ 0.05                | \$ (0.00)        |
| Diluted                                      | \$ 0.12              | \$ 0.08          | \$ 0.05                | \$ (0.00)        |
| Weighted average shares outstanding:         |                      |                  |                        |                  |
| Basic  | 40,055               | 41,133           | 40,227                 | 40,927           |
| Diluted                                      | 50,312               | 42,161           | 40,801                 | 40,927           |

See accompanying notes to consolidated financial statements.

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**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**In Thousands**

**(Unaudited)**

|  | Thirteen Weeks Ended |                  | Twenty-Six Weeks Ended |                  |
|--|----------------------|------------------|------------------------|------------------|
|  | June 27,<br>2003     | June 28,<br>2002 | June 27,<br>2003       | June 28,<br>2002 |
| Net income (loss)  | \$ 5,221             | \$ 3,450         | \$ 2,006               | \$ (146)         |
| Other comprehensive income:                              |                      |                  |                        |                  |
| Foreign currency translation adjustment                  | 769                  | 728              | 1,116                  | 608              |
| Unrealized gain on marketable securities                 | 21                   | —                | 19                     | —                |
| Other comprehensive income before tax                    | 790                  | 728              | 1,135                  | 608              |
| Income tax expense related to other comprehensive income | (277)                | (280)            | (397)                  | (238)            |
| Other comprehensive income, net of tax                   | 513                  | 448              | 738                    | 370              |
| Comprehensive income                                     | \$ 5,734             | \$ 3,898         | \$ 2,744               | \$ 224           |

See accompanying notes to consolidated financial statements.

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**LABOR READY, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**In Thousands**

**(Unaudited)**

|  | Twenty-Six Weeks Ended |                  |
|--|------------------------|------------------|
|  | June 27,<br>2003       | June 28,<br>2002 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                        |                  |
| Net income (loss)  | \$ 2,006               | \$ (146)         |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |                        |                  |
| Depreciation and amortization  | 4,581                  | 4,893            |
| Provision for doubtful accounts  | 4,040                  | 4,937            |
| Deferred income taxes  | (7,477)                | (4,885)          |
| Other operating activities   | 297                    | 795              |
| Changes in operating assets and liabilities:   |                        |                  |
| Accounts receivable  | (18,201)               | (18,857)         |
| Workers' compensation claims reserve   | 4,567                  | 8,746            |
| Other current assets   | 508                    | 1,485            |
| Other current liabilities  | 9,491                  | (1,154)          |
| Net cash used in operating activities  | (188)                  | (4,186)          |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                        |                  |
| Capital expenditures   | (1,545)                | (1,436)          |
| Purchases of marketable securities   | (15,600)               | (1,612)          |
| Maturities of marketable securities  | 7,910                  | —                |
| Other assets   | —                      | (250)            |
| Restricted cash and other assets   | 25,952                 | (13,177)         |
| Net cash provided by (used in) investing activities                                  | 16,717                 | (16,475)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                        |                  |
| Proceeds from sale of stock through options and employee benefit plans               | 1,048                  | 2,555            |
| Payments on debt, net  | (1,169)                | (952)            |
| Proceeds from issuance of convertible Notes  | —                      | 65,000           |
| Payments for offering costs  | (3)                    | (2,447)          |
| Purchase and retirement of common stock  | (4,957)                | (230)            |
| Net cash provided by (used in) financing activities                                  | (5,081)                | 63,926           |
| Effect of exchange rates on cash   | 997                    | 539              |
| Net change in cash and cash equivalents  | 12,445                 | 43,804           |
| CASH AND CASH EQUIVALENTS, beginning of period                                       | 69,255                 | 48,865           |
| CASH AND CASH EQUIVALENTS, end of period   | \$ 81,700              | \$ 92,669        |

See accompanying notes to consolidated financial statement

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**Item 1. Notes to Consolidated Financial Statements**

**NOTE 1: ACCOUNTING PRINCIPLES AND PRACTICES**

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures usually found in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments, which in the opinion of management, are necessary to fairly state the financial position, results of operations and cash

flows for the interim periods presented. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in our annual report on Form 10-K for the year ended December 31, 2002. Certain amounts in the consolidated financial statements at June 28, 2002 have been reclassified to conform to the 2003 presentation. Operating results for the twenty-six week period ended June 27, 2003 are not necessarily indicative of the results that may be expected for the year ending January 2, 2004.

On March 12, 2003, the Board of Directors approved a change in the Company's fiscal year end from December 31 to a 52/53-week fiscal year ending on the Friday closest to December 31. This change will be effective for fiscal year 2003, which will end on January 2, 2004. In fiscal years consisting of 53 weeks, the final quarter will consist of 14 weeks while in 52-week years all quarters will consist of 13 weeks. There will be no transition period for this change in fiscal year end.

**Revenue recognition.** Revenue from the sale of services is recognized at the time the service is performed. A portion of our income is derived from cash dispensing machine fees; such amounts are immaterial for all periods presented. Revenue attributable to sales involving coupons or other incentives are reversed in the period redeemed.

#### NOTE 2: MARKETABLE SECURITIES

Management determines the appropriate classification, pursuant to Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, of our investments in debt and equity securities ("Marketable Securities") at the time of purchase and re-evaluates such determination at each balance sheet date. Marketable Securities consist of revenue bonds and other municipal obligations. The aggregate cost and fair values of our Marketable Securities were \$29.0 million at June 27, 2003. At June 27, 2003, those securities are classified as available-for-sale and stated at fair value with the unrealized holding gains and losses, net of applicable deferred income taxes, reported as a separate component of shareholders' equity. There were no material unrealized holding gains or losses at June 27, 2003. The specific identification method is used for computing realized gains and losses on the sale of available-for-sale securities. For the twenty-six weeks ended June 27, 2003, there were no sales of available-for-sale securities.

#### NOTE 3: RESTRICTED CASH AND OTHER ASSETS

We have cash deposits and other restricted assets with independent financial institutions for the purpose of securing our obligations in connection with our workers' compensation program and for cross collateralization of our Accounts Receivable Facility. These assets may be released as workers' compensation claims are paid or when letters of credit are released.

The following is a summary of restricted cash and other assets as of June 27, 2003 and December 31, 2002 (in millions):

|  | June 27,<br>2003 | December 31,<br>2002 |
|--|------------------|----------------------|
| Workers' Compensation Related                      |                  |                      |
| Workers' Assurance Program cash-backed instruments | \$ 47.5          | \$ 20.4              |
| Secured surety bonds                               | 6.7              | 6.7                  |
| Available for future commitments                   | 2.2              | 29.2                 |
| Subtotal   | 56.4             | 56.3                 |
| Accounts Receivable Facility                       | 13.0             | 39.0                 |
| Total Restricted Cash and Other Assets             | <u>\$ 69.4</u>   | <u>\$ 95.3</u>       |

#### NOTE 4: LONG-TERM DEBT

During 2002, the Company issued 6.25% Convertible Subordinated Notes due 2007 (the "Notes") in the aggregate principal amount of \$70.0 million. Interest is payable on the Notes on June 15 and December 15 of each year. Holders may convert the Notes into shares of Company common stock at any time prior to the maturity date at a conversion price of \$7.26 per share (equivalent to an initial conversion rate of approximately 137.741 shares per \$1,000 principal amount of Notes), subject to certain adjustments. The Notes are unsecured subordinated obligations and rank junior in right of payment to all existing and future debt that would constitute senior debt under the indenture, including letters of credit and surety bonds. On or after June 20, 2005, the Company may redeem some or all of the Notes for cash at 100% of their principal amount plus accrued interest if the market value of our common stock equals or exceeds 125% of the conversion price for at least 20 trading days in any consecutive 30 trading day period.

#### NOTE 5: WORKERS' COMPENSATION INSURANCE

We provide workers' compensation insurance to our temporary workers and regular employees. For workers' compensation claims originating in the majority of states (which we refer to as self-insured states), we have purchased insurance policies from independent, third-party carriers, which cover any claims for a particular event above a \$2.0 million deductible, on a "per occurrence" basis. This results in our being substantially self-insured. However, should any single occurrence exceed the deductible amount, all losses and expenses beyond the deductible amount are the responsibility of the insurance carrier.

For workers' compensation claims originating in Washington, Ohio, West Virginia, North Dakota, Wyoming, Canada and Puerto Rico (the "monopolistic jurisdictions") we pay workers' compensation insurance premiums and obtain full coverage under government-administered programs. For work related claims originating in the United Kingdom which exceed amounts covered by governmental medical insurance programs, we have purchased an employers' liability insurance policy that carries a 25 million British Pound limit in total.

We establish a reserve for the deductible portion of our workers' compensation claims using actuarial estimates of the future cost of claims and related expenses that have been reported but not settled, and that have been incurred but not reported. Adjustments to the claims reserve are charged or credited to expense in the periods in which they occur. Included in the accompanying consolidated balance sheets as of June 27, 2003 and December 31, 2002 are workers' compensation claims reserves in the amounts of \$90.5 million and \$85.9 million, respectively. The claims reserves were computed using a discount rate of 5.0%. The selection of this discount rate is based on the returns of "A" grade bonds with maturities comparable to the average life of our workers' compensation claims.

Workers' compensation expense recorded as part of cost of services consists of the following components: self-insurance reserves net of changes in discount, monopolistic jurisdictions premium and insurance premium. Workers' compensation expense totaling \$16.1 million and \$17.5 million was recorded for the thirteen weeks ended June 27, 2003 and June 28, 2002, respectively. Workers' compensation expense totaling \$29.0 million and \$30.6 million was recorded for the twenty-six weeks ended June 27, 2003 and June 28, 2002, respectively.

#### NOTE 6: NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing adjusted net income by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares include the dilutive effects of outstanding options and the conversion features of the Notes, except where their inclusion would be anti-dilutive. The anti-dilutive shares not considered as part of our calculation are as follows:

(Amounts in Thousands)

|                   | Thirteen Weeks Ended |                  | Twenty-Six Weeks Ended |                  |
|-------------------|----------------------|------------------|------------------------|------------------|
|                   | June 27,<br>2003     | June 28,<br>2002 | June 27,<br>2003       | June 28,<br>2002 |
| Stock Options     | 1,610                | 2,170            | 2,076                  | 2,170            |
| Convertible Notes | —                    | 885              | 9,642                  | 450              |

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Anti-dilutive shares associated with our options relate to those options whose grant price is higher than the average market value of our stock during the period presented. We have anti-dilutive shares associated with our convertible Notes when net income per share would have been higher had the Notes been converted to equity (the "if-converted" calculation). The Notes are anti-dilutive in quarters when our net income per share is \$.08 or lower. The number of additional shares associated with the Notes is equal to the face amount of the Notes, \$70,000, divided by the stated conversion price of \$7.26, or 9,642 shares. Those shares were subject to a weighted average calculation in the thirteen week and twenty-six week periods ended June 28, 2002 because they were not outstanding for the entire periods.

|  | Thirteen Weeks Ended                                 |                  |
|--|--|------------------|
|  | June 27,<br>2003                                     | June 28,<br>2002 |
| Net income   | \$ 5,221   | \$ 3,450         |
| Adjustments:   |  |                  |
| Interest on Notes  | 1,106  | .00              |
| Amortization of costs for Notes issuance   | 148  | .00              |
| Tax impact   | (440)  | .00              |
| Total adjustments  | 815  | .00              |
| Adjusted net income  | \$ 6,035   | \$ 3,450         |
|  | <b>Common Shares and<br/>Potential Common Shares</b> |                  |
| Weighted average number of common shares used in basic net income per common share                               | 40,055   | 41,133           |
| Effect of dilutive securities:   |  |                  |
| Stock options  | 615  | 1,028            |
| Convertible Notes  | 9,642  | —                |
| Weighted average number of common shares and potential common shares used in diluted net income per common share | 50,312   | 42,161           |
|  | <b>Twenty-Six Weeks Ended</b>                        |                  |
|  | June 27,<br>2003                                     | June 28,<br>2002 |
| Net income (loss) and adjusted net income (loss)   | \$ 2,006   | \$ (146)         |
|  | <b>Common Shares and<br/>Potential Common Shares</b> |                  |
| Weighted average number of common shares used in basic net income (loss) per common share                        | 40,227   | 40,927           |
| Effect of dilutive securities:   |  |                  |
| Stock options  | 574  | —                |
| Convertible Notes  | —  | —                |
| Weighted average number of common shares and potential common shares used in diluted net income per common share | 40,801   | 40,927           |

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## NOTE 7: COMMITMENTS AND CONTINGENCIES

### Accounts Receivable Facility

In March 2001, we entered into a letter of credit facility and accounts receivable securitization facility (collectively the "Accounts Receivable Facility") with certain unaffiliated financial institutions that expires in February of 2006. The Accounts Receivable Facility provides loan advances and letters of credit through the sale of substantially all of our eligible domestic accounts receivable to a wholly owned and consolidated subsidiary, Labor Ready Funding Corporation. The Accounts Receivable Facility is guaranteed by the Company and requires that we meet certain financial covenants. Among other things, these covenants require us to maintain certain liquidity, net income and net worth levels and a certain ratio of net income to fixed expenses. Subject to certain availability requirements, the Accounts Receivable Facility allows us to borrow a maximum of \$80 million, all of which may be used to obtain letters of credit. The amounts we may borrow (our borrowing capacity) under this agreement are largely a function of the levels of our accounts receivable from time to time, supplemented by pledged and restricted cash.

At June 27, 2003 we had a total available borrowing capacity of \$72.1 million under the Accounts Receivable Facility comprised of \$59.7 million of accounts receivable and \$12.4 of restricted cash. The \$59.7 million represents the available portion of our total \$79.8 million of securitized accounts receivable and the \$12.4 million represents the available portion of the \$13.0 million of restricted cash cross collateralizing the Accounts Receivable Facility. Of that borrowing capacity available at June 27, 2003, we had \$63.2 million of letters of credit issued against it leaving us with \$8.9 million available for future borrowings. We currently use this facility to issue letters of credit but if we were to take a loan against this borrowing capacity, interest would be charged at 1.1% above the Commercial Paper rate. We are currently in compliance with all covenants related to the Accounts Receivable Facility.

We are required by our insurance carriers and certain state workers' compensation programs to collateralize a portion of our workers' compensation obligation with irrevocable letters of credit, cash-backed instruments, or surety bonds. The letters of credit bear annual fluctuating fees, which were approximately 0.8% of the principal

amount of the letters of credit as of June 27, 2003. The surety bonds bear fees based on a percentage of the bond, which is determined by each independent surety carrier but does not exceed 2% of the bond amount.

At June 27, 2003 and December 31, 2002 we had provided our insurance carriers and certain states with commitments in the form and amounts outlined below (in millions):

|  | June 27,<br>2003 | December 31,<br>2002 |
|--|------------------|----------------------|
| Accounts Receivable Facility letters of credit     | \$ 63.2          | \$ 79.9              |
| Secured surety bonds                               | 6.7              | 6.7                  |
| Unsecured surety bonds                             | 6.5              | 19.4                 |
| Workers' Assurance Program cash-backed instruments | 47.5             | 20.4                 |
| Total Collateral Commitments                       | <u>\$ 123.9</u>  | <u>\$ 126.4</u>      |

Subsequent to quarter-end, we increased our letters of credit in the Accounts Receivable Facility by \$10.0 million, reduced our unsecured surety bonds by \$0.5 million and increased our secured surety bonds by \$1.6 million.

#### Revolving Credit Facility

In January of 2002, we entered into a revolving credit facility with Wells Fargo Bank (the "Revolving Credit Facility"). As of June 27, 2003 the available borrowing amount was \$9.4 million with interest at the fluctuating rate per annum of 0.75% below the Prime Rate or 1.85% above the London Inter-Bank Rate. The available borrowing amount under this facility will be reduced by \$125,000 each quarter through 2006 at which time the facility expires. The Revolving Credit Facility bears fees of 0.35% of the unused amount, and is secured by a first deed of trust on our corporate headquarters building. The Revolving Credit Facility contains a cross-default provision with respect to our Accounts Receivable Facility, which obligates us, among other things, to maintain certain liquidity, net income and net worth levels and a certain ratio of net income to fixed expenses. We currently do not have any borrowings on the Revolving Credit Facility and are in compliance with all covenants.

#### Legal Contingencies and Developments

From time to time we are the subject of compliance audits by federal, state and local authorities relating to a variety of regulations including wage and hour laws, taxes, workers' compensation, immigration and safety. From time to time we are also subject to legal proceedings in the ordinary course of our operations. In accordance with accounting principles generally accepted in the United States, we have established reserves for contingent legal and regulatory liabilities, based on management's current best estimates and judgments of the scope and likelihood of such liabilities. We believe that none of the currently pending legal proceedings, individually or in the aggregate, will have a material adverse impact on our financial condition, results of operations or cash flows beyond amounts that have been accrued in the financial statements, although we can make no assurances in this regard.

On October 3, 2000, Willie Wilkerson, Marco Medina and Arthur Demarchis filed an action in California State Court, Santa Clara County (the "Wilkerson Litigation") alleging violations of state law in connection with the fees charged by us for optional use of our cash dispensing machines (CDMs). The plaintiffs are present or former workers for us who sought unquantified damages, injunctive relief and certification of a class of workers. On June 25, 2002, the court certified a class of plaintiffs consisting of all workers who used the CDMs from 1998 to present. In December 2002, we agreed to a settlement of this case in order to avoid further cost of litigation. The settlement is subject to court approval. Under the terms of the settlement, we have agreed to make a contribution to a California charitable organization in the amount of \$0.1 million, and would pay an additional \$0.1 million for the plaintiffs' attorneys' fees.

On February 14, 2001, Armando Ramirez, Phyllis Stennis, Earl Levels and Maurice Johnson filed an action in California State Court, Alameda County (the "Ramirez Litigation"), alleging violation of federal or state wage and hour laws for failing to pay workers for all hours worked. The plaintiffs are present or former workers for us and seek unquantified damages, injunctive relief and certification of a class of workers. On July 12, 2002, the court certified classes of plaintiffs in connection with claims relating to waiting time, travel time and equipment charges for the period of February 1998 to present. The court declined to certify classes of plaintiffs in connection with claims relating to transportation expenses and unfair competition.

On July 29, 2002, Marisol Balanderan and 55 other plaintiffs filed an action against us and one of our customers in California State Court, Los Angeles County. The plaintiffs are present or former workers and job applicants who seek unquantified compensatory and punitive damages based on allegations that they were subjected to discrimination in dispatch to jobs on the basis of their female gender, throughout a period from September 2001 through January 2002. They also seek certification of a class of similarly situated workers.

On February 6, 2003, Scott Romer, a former Account Representative, and Shauna Clark, a former Level III Customer Service Representative, filed an action against us in California State Court, Los Angeles County. The plaintiffs allege that they were wrongfully exempted from entitlement to overtime pay during their employment. They seek unquantified compensatory damages and certification of a class of similarly situated workers.

#### NOTE 8: SUPPLEMENTAL CASH FLOW INFORMATION

|  | Twenty-Six Weeks Ended |                  |
|--|------------------------|------------------|
|  | June 27,<br>2003       | June 28,<br>2002 |
| (Amounts in Thousands)                         |                        |                  |
| Cash paid during the period for:               |                        |                  |
| Interest                                       | \$ 2,688               | \$ 566           |
| Income taxes                                   | \$ 2,091               | \$ (148)         |
| Non-cash investing and financing activities:   |                        |                  |
| Assets acquired with capital lease obligations | \$ 294                 | \$ 766           |
| Contribution of common stock to 401(k) plan    | \$ 285                 | \$ 277           |
| Unrealized gain on marketable securities       | \$ 19                  | \$ —             |

#### NOTE 9: EMPLOYEE STOCK PURCHASE PLAN

We have an Employee Stock Purchase Plan (the "ESPP") to provide substantially all regular employees who have completed six months of service and meet certain limited

qualifications, relative to weekly total hours and calendar months worked, an opportunity to purchase shares of our common stock through payroll deductions. The ESPP permits payroll deductions up to 10% of eligible after-tax compensation. Participant account balances are used to purchase shares of common stock at the lesser of 85% of the fair market value of shares on either the first day or the last day of each month. The ESPP expires on June 30, 2006. 1.9 million shares of common stock have been reserved for purchase under the ESPP. During the twenty-six weeks ended June 27, 2003, participants purchased 58,000 shares in the ESPP for cash proceeds of \$0.3 million.

#### NOTE 10: STOCK OPTION PLANS

We have stock option plans for directors, officers, and employees, which provide for nonqualified and incentive stock options. The majority of our options vest evenly over a four-year period from the date of grant and expire if not exercised within five years from the date of grant.

The fair value of option grants is estimated on the date of grant utilizing the Black-Scholes option pricing model with the following weighted average assumptions for grants in 2003: expected life of options of 3.5 years, expected volatility of 79%, risk-free interest rates of 4.0% and a 0% dividend yield.

The Company accounts for its stock-based compensation plans under Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*. The pro forma information below is based on provisions of Statement of Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*, issued in December 2002.

(In thousands, except per share amount):

|                                       | Twenty-Six Weeks Ended<br>June 27, 2003 |       |
|---------------------------------------|---|-------|
| <b>Net Income</b>                     |   |       |
| As Reported                           | \$                                      | 2,006 |
| Pro Forma                             | \$                                      | 1,249 |
| <b>Income Per Share – As Reported</b> |   |       |
| Basic                                 | \$                                      | 0.05  |
| Diluted                               | \$                                      | 0.05  |
| <b>Income Per Share – Pro Forma</b>   |   |       |
| Basic                                 | \$                                      | 0.03  |
| Diluted                               | \$                                      | 0.03  |

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The following table summarizes stock option activity:

|  | Twenty-Six Weeks Ended<br>June 27, 2003 |                |
|--|---|----------------|
|  | Shares                                  | (1)<br>Price   |
| Outstanding at beginning of period                               | 5,397                                   | \$ 6.52        |
| Granted  | 257                                     | \$ 6.20        |
| Exercised  | (189)                                   | \$ 3.93        |
| Canceled   | (447)                                   | \$ 9.26        |
| Outstanding at the end of the period                             | <u>5,018</u>                            | <u>\$ 6.33</u> |
| Exercisable at the end of the period                             | <u>2,108</u>                            | <u>\$ 7.59</u> |
| Weighted average fair value of options granted during the period |   | <u>\$ 2.22</u> |

(1) Weighted average exercise price.

At June 27, 2003, 1,672 shares of common stock were available for future grant under our stock option plans.

Information relating to stock options outstanding and exercisable at June 27, 2003 is as follows (in thousands, except per share amounts):

| Range of Exercise Prices | Outstanding Options |                               |                              | Exercisable Options |                              |
|--------------------------|---------------------|-------------------------------|------------------------------|---------------------|------------------------------|
|                          | Shares              | Weighted<br>Remaining<br>Life | Weighted<br>Average<br>Price | Shares              | Weighted<br>Average<br>Price |
| \$ 3.05 - \$ 3.80        | 1,519               | 2.92                          | \$ 3.48                      | 738                 | \$ 3.53                      |
| \$ 3.81 - \$ 6.00        | 1,423               | 3.32                          | \$ 5.13                      | 509                 | \$ 5.00                      |
| \$ 6.01 - \$ 14.00       | 1,654               | 3.64                          | \$ 7.26                      | 465                 | \$ 8.84                      |
| \$ 14.01 - \$ 21.00      | 422                 | .66                           | \$ 16.95                     | 396                 | \$ 17.03                     |
| \$ 3.05 - \$ 21.00       | <u>5,018</u>        | <u>3.08</u>                   | <u>\$ 6.33</u>               | <u>2,108</u>        | <u>\$ 7.59</u>               |

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

This Form 10-Q contains forward-looking statements. These statements relate to our expectations for future events and future financial performance. Generally, the words “anticipate,” “expect,” “intend” and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. These statements are only predictions. Actual events or results may differ materially. Factors which could affect our financial results are described in Item 3, Item 7 and Item 7A of Part 1 of our Form 10-K for the year ended December 31, 2002 and in the “Risk Factors” included in this Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We



assume no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

## Overview

Labor Ready is a national provider of temporary workers for manual labor jobs. Our customers are primarily in transportation, warehousing, hospitality, landscaping, construction, light manufacturing, retail, wholesale, sanitation and printing industries. During 2002, we put approximately 600,000 people to work through our dispatch offices in all 50 of the United States, in Puerto Rico, in five provinces of Canada and in the United Kingdom. We served more than 275,000 customers in 2002 and are not dependent on any individual customer for more than 2% of our annual revenue. Our annual revenue was \$862.7 million in 2002, and was \$388.0 million and \$389.2 million for the twenty-six weeks ended June 27, 2003 and June 28, 2002, respectively.

We had 790 operating branches as of June 27, 2003 after opening 26 branch offices and closing 5 during the quarter. Of those openings, 20 were within our international operations. We see opportunities for growth of our business, including additional opportunities to expand operations overseas, although we have completed all our anticipated expansion for 2003. Revenues from international operations for the twenty-six weeks ended June 27, 2003 was approximately 6.1% of our total revenue. We are focusing on increasing the revenue and profitability in each dispatch office through the implementation of measures designed to control costs and improve customer satisfaction, marketing effectiveness and retention and training of our dispatch office staff.

Our business includes an element of seasonal fluctuation. Construction and landscaping businesses and, to a lesser degree, other customer businesses, typically increase activity in spring, summer and early fall months and decrease activity in late fall and winter months. Inclement weather can slow construction and landscaping activities in such periods. As a result, we generally experience an increase in temporary labor demand in the spring, summer and early fall months, and lower demand in the late fall and winter months.

Gross profit reflects the difference between our revenue from services and the cost of services. Cost of services includes the wages and related payroll taxes of temporary workers, workers' compensation expense, unemployment compensation insurance and transportation. Gross profit has historically been affected by numerous factors, including competitive pressures on billing rates, wage rate increases, increases in payroll related taxes, and increases in workers' compensation charges. Pressure on our margins has been intense since 2002. However, we have implemented policies, procedures and training focused on pay rates and other components of cost of services. We have been successful in producing stronger margins thus far in 2003, although we may still experience fluctuations in our margins from time to time.

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

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

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**Workers' Compensation Reserves.** We maintain reserves for workers' compensation claims using actuarial estimates of the future cost of claims and related expenses that have been reported but not settled, and that have been incurred but not reported. This reserve, which reflects potential liabilities to be paid in future periods based on estimated payment patterns, is discounted to net present value. We are currently using a discount rate of 5%. The selection of the discount rate is based on the returns of "A" grade bonds with maturities comparable to the average life of our workers' compensation claims. We evaluate the reserve regularly throughout the year and make adjustments as needed. If the actual cost of such claims and related expenses exceeds the amounts estimated, or if the discount rate must be lowered, additional reserves may be required.

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

**Reserves for Contingent Legal and Regulatory Liabilities.** We have established reserves for contingent legal and regulatory liabilities, based on management's estimates and judgments of the scope and likelihood of such liabilities. We evaluate this reserve regularly throughout the year and make adjustments as needed. If the actual outcome of these matters is less favorable than expected, an adjustment would be charged to expense in the period the outcome occurs or the period in which our estimate changes.

## Liquidity and Capital Resources

### Cash Flow Summary

Net cash used in operating activities was \$0.2 million for the twenty-six week period ended June 27, 2003 compared to \$4.2 million for the same period ended June 28, 2002. The increase in cash flows from operations in 2003 as compared to 2002 is largely due to slower growth in our workers' compensation claims reserve due to stabilization in prior years' reserve balances, net income versus a net loss in the prior year and fluctuations in the balances of other current liabilities and deferred income taxes.

We typically pay our temporary workers on a daily basis, bill our customers weekly, and, on average, collect monthly. Consequently, from time to time we may experience negative cash flow from operations.

The change in cash from investing activities for the twenty-six week period ending June 27, 2003 as compared to the same period ending June 28, 2002 is due mostly to changes in restricted cash and other assets. Our restricted cash and other assets are used primarily to collateralize our workers' compensation program and our Accounts Receivable Facility. We reduced our restricted cash and other assets by \$26.0 million during the first half of 2003 compared to an increase in these accounts of \$13.1 million during the first half of 2002. This fluctuation is due to periodic shifts in the form and mix of collateral making up our total workers' compensation commitments. At the end of the second quarter of 2002, we had \$27.0 million of restricted cash cross collateralizing our Accounts Receivable Facility as compared to \$13.0 million at the end of the second quarter of 2003. The remaining offsetting decrease in cash provided by investing activities is due to the net increase in investments in marketable securities from \$7.7 million at June 28, 2002 to \$29.0 million at June 27, 2003.

Net cash provided by (used in) financing activities was (\$5.1) million for the twenty-six weeks ended June 27, 2003 and \$63.9 million for the twenty-six weeks ended June 28, 2002. The cash provided by financing activities in 2002 was largely the result of proceeds received from the issuance of the convertible Notes. The cash used in financing activities in 2003 is primarily the result of common stock repurchases of approximately 839,000 shares in the amount of \$5.0 million. Our Board of Directors has authorized repurchases of up to an additional 1.4 million shares.

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The following table provides a summary of our contractual obligations as of June 27, 2003 by due date:

|   | Payments Due By Year (In Thousands) |                     |                 |                  |                  |
|---|-------------------------------------|---------------------|-----------------|------------------|------------------|
|   | Total                               | Less than<br>1 Year | 1-3<br>Years    | 4-5<br>Years     | After 5<br>Years |
| <b>Contractual Obligations</b>            |                                     |                     |                 |                  |                  |
| Long-term debt (a)                        | \$ 70,000                           | —                   | —               | \$ 70,000        | —                |
| Capital lease obligations (b)             | 5,005                               | 2,521               | 2,309           | 175              | —                |
| Operating leases (c)                      | 2,069                               | 1,100               | 874             | 95               | —                |
| Other long-term obligations (d)           | 6,102                               | 3,839               | 2,263           | —                | —                |
| <b>Total Contractual Cash Obligations</b> | <b>\$ 83,176</b>                    | <b>\$ 7,460</b>     | <b>\$ 5,446</b> | <b>\$ 70,270</b> | <b>—</b>         |

- (a) Convertible Subordinated Notes further described in Note 4 of Notes to Consolidated Financial Statements Found in Item 1 of Part I of this Form 10-Q.  
(b) Primarily payments on leases of the Cash Dispensing Machines (CDMs), which include interest and tax amounts.  
(c) Excludes all payments related to leases cancelable within ninety days.  
(d) Voice and data service contracts.

The following table provides a summary, by period of expiration, of commercial commitments and other commitment capacity available to us as of June 27, 2003:

|   | Amount of Commitment Expiration Per Period (in thousands) |                     |                  |              |                  |
|---|---|---------------------|------------------|--------------|------------------|
|   | Total   | Less than<br>1 Year | 1-3<br>Years     | 4-5<br>Years | After 5<br>Years |
| <b>Other Commercial Commitments</b>                               |   |                     |                  |              |                  |
| Accounts Receivable Facility (e)                                  | \$ 80,000   | —                   | \$ 80,000        | —            | —                |
| Line of credit (f)  | 9,375   | 500                 | 8,875            | —            | —                |
| Secured surety bonds  | 6,700   | 6,700               | —                | —            | —                |
| Unsecured surety bonds  | 7,500   | 7,500               | —                | —            | —                |
| <b>Total Commercial Commitments</b>                               | <b>\$ 103,575</b>   | <b>\$ 14,700</b>    | <b>\$ 88,875</b> | <b>—</b>     | <b>—</b>         |
| <b>Other Commitment Capacity</b>                                  |   |                     |                  |              |                  |
| Workers' Assurance Program (g)                                    | 49,649  |                     |                  |              |                  |
| <b>Total Commercial Commitments and other Collateral Capacity</b> | <b>\$ 153,224</b>   |                     |                  |              |                  |
| <b>Total Collateral Commitments Outstanding At June 27, 2003</b>  | <b>(123,900)</b>  |                     |                  |              |                  |
| <b>Available Commitment Capacity</b>                              | <b>\$ 29,324</b>  |                     |                  |              |                  |

- (e) See Note 7 of Notes to Consolidated Financial Statements found in Item 1 of Part I of this Form 10-Q.  
(f) No balance outstanding. See description of Revolving Credit Facility below.  
(g) See description below in Capital Resources.

### Capital Resources

In March 2001, we entered into a letter of credit facility and an accounts receivable securitization facility (collectively the "Accounts Receivable Facility") with certain unaffiliated financial institutions that expires in February of 2006. The Accounts Receivable Facility provides loan advances through the sale of substantially all of our eligible domestic accounts receivable to a wholly owned and consolidated subsidiary, Labor Ready Funding Corporation. The Accounts Receivable Facility includes a corporate guarantee by us and requires that we meet certain financial covenants. Among other things, these covenants require us to maintain certain liquidity, net income and net worth levels and a certain ratio of income to fixed charges. Subject to certain availability requirements, the Accounts Receivable Facility allows us to borrow a maximum of \$80 million, all of which may be used to obtain letters of credit. The amounts we may borrow (our borrowing capacity) under this agreement are largely a function of the levels of our accounts receivable from time to time, supplemented by pledged and restricted cash. We currently use this facility to issue letters of credit but if we were to take a loan against this borrowing capacity, interest would be charged at 1.1% above the Commercial Paper rate. We are currently in compliance with all covenants related to the Accounts Receivable Facility.

We have agreements with certain financial institutions through our wholly owned and consolidated subsidiary, Workers' Assurance of Hawaii, Inc. (our "Workers' Assurance Program"), that allow us to restrict cash for the purpose of providing cash-backed instruments for our workers' compensation collateral. At June 27, 2003 we had restricted cash in our Workers' Assurance Program totaling \$49.6 million. Of this cash, \$47.5 million was committed to insurance carriers leaving \$2.1 million available for future needs.

In January of 2002, we entered into a revolving credit facility with Wells Fargo Bank (the "Revolving Credit Facility"). As of June 27, 2003 the available borrowing amount was \$9.4 million with interest at the fluctuating rate per annum of .75% below the Prime Rate or 1.85% above the London Inter-Bank Rate. The available borrowing amount under this facility will be reduced by \$125,000 each quarter through 2006 at which time the facility expires. The Revolving Credit Facility bears fees of 0.35% of the unused amount, and is secured by a first deed of trust on our corporate headquarters building. The Revolving Credit Facility contains a cross-default provision with respect to our Accounts Receivable Facility, which obligates us, among other things, to maintain certain liquidity, net income and net worth levels and a certain ratio of net income to fixed expenses. We currently do not have any borrowings on the Revolving Credit Facility and are in compliance with all covenants.

During 2002, the Company issued 6.25% Convertible Subordinated Notes due 2007 (the "Notes") in the aggregate principal amount of \$70.0 million. Interest is payable on the Notes on June 15 and December 15 of each year. Holders may convert the Notes into shares of Company common stock at any time prior to the maturity date at a conversion price of \$7.26 per share (equivalent to an initial conversion rate of approximately 137.741 shares per \$1,000 principal amount of Notes), subject to certain adjustments. The Notes are unsecured subordinated obligations and rank junior in right of payment to all existing and future debt that would constitute senior debt under the indenture, including letters of credit and surety bonds. On or after June 20, 2005, the Company may redeem some or all of the Notes at 100% of their principal amount plus accrued interest if the market value of our common stock equals or exceeds 125% of the conversion price for at least 20 trading days in any consecutive 30 trading day period.

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

*Workers' Compensation Collateral and Claims Reserves*

We provide workers' compensation insurance to our temporary workers and regular employees. For workers' compensation claims originating in the majority of states (which we refer to as self-insured states), we have purchased insurance policies from independent, third-party carriers, which cover any claims for a particular event above a \$2.0 million deductible, on a "per occurrence" basis. This results in our being substantially self-insured. However, should any single occurrence exceed the deductible amount per occurrence, all losses and expenses beyond the deductible amount would be the responsibility of the insurance carrier.

We are required by our insurance carriers and certain state workers' compensation programs to collateralize a portion of our workers' compensation liability with irrevocable letters of credit, cash-backed instruments, or surety bonds. Our insurance carriers annually assess the amount of collateral they will require from us relative to our workers' compensation liability for which they are responsible. Such amounts can increase or decrease independent of our assessments and reserves. At June 27, 2003 and December 31, 2002 we had provided our insurance carriers and certain states with commitments in the form and amounts outlined below (in millions):

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|  | June 27,<br>2003 | December 31,<br>2002 |
|--|------------------|----------------------|
| Accounts Receivable Facility letters of credit     | \$ 63.2          | \$ 79.9              |
| Secured surety bonds                               | 6.7              | 6.7                  |
| Unsecured surety bonds                             | 6.5              | 19.4                 |
| Workers' Assurance Program cash-backed instruments | 47.5             | 20.4                 |
| <b>Total Collateral Commitments</b>                | <b>\$ 123.9</b>  | <b>\$ 126.4</b>      |

Our total collateral commitments exceed our workers' compensation reserve due to several factors including, (a) our claims reserves are discounted to net present value and our collateral commitments are based on the gross, undiscounted reserve, (b) a lag in the timing of the release of collateral related to claims that have been previously paid and, therefore, are no longer reflected in the reserve, and (c) the obligation to post commitments prior to incurring the liability associated with our reserve.

Subsequent to quarter-end, we increased our letters of credit in the Accounts Receivable Facility by \$10.0 million, reduced our unsecured surety bonds by \$0.5 million and increased our secured surety bonds by \$1.6 million.

The letters of credit bear fluctuating annual fees, which were approximately 0.8% of the principal amount of the letters of credit as of June 27, 2003. Our surety bonds are issued by independent insurance companies on our behalf and bear annual fees based on a percentage of the bond, which is determined by each independent surety carrier, but does not exceed 2.0% of the bond amount. The terms of these bonds are subject to annual review and renewal and the bonds can be canceled by the sureties with as little as 60 days notice.

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

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

|  | (Amounts in Thousands) |                  |                        |                  |
|--|------------------------|------------------|------------------------|------------------|
|  | Thirteen Weeks Ended   |                  | Twenty-Six Weeks Ended |                  |
|  | June 27,<br>2003       | June 28,<br>2002 | June 27,<br>2003       | June 28,<br>2002 |
| Beginning Balance                                    | \$ 87,356              | \$ 65,501        | \$ 85,894              | \$ 61,615        |
| Self-Insurance Reserve Expenses                      |                        |                  |                        |                  |
| Expenses related to current period (net of discount) | 12,437                 | 12,003           | 22,267                 | 20,886           |
| Expenses related to prior years                      | 414                    | 2,458            | 414                    | 4,657            |
| Total  | 12,851                 | 14,461           | 22,681                 | 25,543           |
| Amortization of prior year discount                  | 293                    | 703              | 2,061                  | 1,474            |
| Payments   |                        |                  |                        |                  |
| Payments related to current period                   | (1,515)                | (1,575)          | (1,707)                | (1,685)          |
| Payments related to prior years                      | (8,524)                | (8,729)          | (18,468)               | (16,586)         |
| Total  | (10,039)               | (10,304)         | (20,175)               | (18,271)         |
| Ending Balance                                       | <b>\$ 90,461</b>       | <b>\$ 70,361</b> | <b>\$ 90,461</b>       | <b>\$ 70,361</b> |

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Our workers compensation reserve is established using estimates of the future cost of claims and related expenses that have been reported but not settled, as well as those that have been incurred but not reported. Throughout the year, management regularly reviews and evaluates the adequacy of reserves for prior periods, and establishes rates for future accruals. Adjustments to prior period reserves are charged or credited to expense in the periods in which the estimate changes. Our claims reserves are computed using a discount rate of 5.0%.

Factors we consider in establishing and adjusting these reserves include, among other things, (a) the estimates provided by our independent actuaries, (b) our mix of business by state and by type of work performed, (c) industry and nationwide trends in benefit costs, (d) appropriate discount rates and estimated payment patterns, and (e) future savings related to claims management and other cost containment measures. Factors that have caused our estimated losses for prior years to change include, among other things, (i) inflation of medical and indemnity costs at a rate higher than originally anticipated, (ii) regulatory and legislative developments that have increased benefits and settlement requirements in several states, (iii) a different mix of business than previously anticipated, and (iv) adjustments to the discount rate.

*Recent Development Related to Workers' Compensation Collateral and Insurance Coverage.*

We recently secured new workers' compensation insurance. Effective July 1, 2003, we selected American International Group, Inc. (AIG) as our provider of workers' compensation insurance replacing Kemper Insurance Company (Kemper). The terms and conditions in the AIG agreement are substantially equivalent to the terms and conditions of our prior agreement with Kemper, including a \$2.0 million "per occurrence" deductible.

#### Other

Included in cash and cash equivalents at June 27, 2003 is cash held within dispatch office CDMs for payment of temporary payrolls in the amount of approximately \$14.0 million as compared to \$15.5 million at June 28, 2002.

Our capital expenditures for the twenty-six weeks ended June 27, 2003 and June 28, 2003 were \$1.8 million and \$2.2 million, respectively. We anticipate that our capital expenditures will be an additional \$4.2 million in 2003.

### Results of Operations

#### Thirteen Weeks Ended June 27, 2003 Compared to Thirteen Weeks Ended June 28, 2002

The following table compares the operating results for the thirteen weeks ended June 27, 2003 and June 28, 2002 (in thousands):

|  | Thirteen Weeks Ended |                  |                   |
|--|----------------------|------------------|-------------------|
|  | June 27,<br>2003     | June 28,<br>2002 | Percent<br>Change |
| Revenue from services                        | \$ 215,684           | \$ 219,100       | (1.6)             |
| Cost of services                             | 150,710              | 156,141          | (3.5)             |
| Selling, general and administrative expenses | 53,868               | 54,347           | (0.9)             |
| Depreciation and amortization                | 2,044                | 2,672            | (23.5)            |
| Interest and other expense, net              | (1,020)              | (330)            | 209.1             |
| Income before tax expense                    | 8,042                | 5,610            | 43.4              |
| Net income                                   | \$ 5,221             | \$ 3,450         | 51.3              |

**Dispatch Offices and Revenue from Services.** The number of offices increased to 790 at June 27, 2003 from 753 locations at June 28, 2002. Revenue in the second quarter declined slightly by 1.6% as compared to the same quarter a year earlier. The change in revenue was made up of the following three components: (a) a 2.2% decline in same branch revenue, defined as those branches opened one year or longer, (b) a 40 basis point decline in revenue related to closing 18 branches since the second quarter of 2002 and (c) the 1% growth in revenue from new branches opened this year. Revenues from our international operations for the thirteen weeks ended June 27, 2003 were approximately 6.1% of our total revenues compared to 5.7% for the same period last year.

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#### Cost of Services and Gross Margin

Cost of services decreased to 69.9% of revenue for the thirteen weeks ended June 27, 2003 compared to 71.3% for the thirteen weeks ended June 28, 2002. The decrease in cost of services as a percent of revenue is due to the fact that our average bill rate increased by nearly 2.3% this quarter over a year earlier while our average pay rate increased 0.3%. Additionally, workers' compensation expense as a percent of revenue declined to 7.4% from 8.0% a year earlier, as prior years' reserve balances stabilized. As a result, our gross margins were 30.1% for the thirteen weeks ended June 27, 2003 compared to 28.7% for the thirteen weeks ended June 28, 2002.

**Selling, General, and Administrative Expenses.** Selling, general and administrative ("SG&A") expenses have remained fairly consistent as we continue to make a company-wide, concerted effort to reduce costs. SG&A expenses were 25.0% of revenue for the thirteen weeks ended June 27, 2003 compared to 24.8% of revenue for the thirteen weeks ended June 28, 2002.

**Depreciation and Amortization Expense.** Depreciation and amortization expenses have decreased to \$2.0 million for the thirteen weeks ended June 27, 2003 from \$2.7 million for the same period in 2002. The decrease is largely the result of a one-time adjustment for a change in the estimated useful lives of certain assets during the second quarter of 2002.

**Interest and Other Expense, Net.** We recorded interest and other expense, net of interest income, of (\$1.0) million for the thirteen weeks ended June 27, 2003 as compared to (\$0.3) million for the thirteen weeks ended June 28, 2002. The increase in interest expense in 2003 is a result of the interest on the 6.25% Convertible Subordinated Notes due 2007 (the "Notes") that were issued in June 2002.

**Taxes On Income.** Our effective tax rate was 35.1% for the thirteen weeks ended June 27, 2003 compared to 38.5% for the thirteen weeks ended June 28, 2002. The decrease in 2003 as compared to 2002 is largely a result of increased utilization of Work Opportunity, Welfare to Work and Empowerment Zone tax credits. The principal difference between the statutory federal income tax rate and our effective income tax rate results from state income taxes, federal credits, certain non-deductible expenses and the valuation allowance discussed below.

We have a net deferred tax asset of approximately \$26.1 million at June 27, 2003 resulting primarily from workers' compensation reserves, allowance for doubtful accounts and other non-deductible reserves. We have assessed our past earnings history and trends, projected sales, expiration dates of loss carry-forwards, and our ability to implement tax planning strategies which are designed to accelerate or increase taxable income. Based on the results of this analysis and the uncertainty of the realization of certain tax planning measures, we have established a valuation allowance against our carryforward benefits in the amount of \$3.5 million at June 27, 2003 and \$2.2 million at June 28, 2002.

#### Twenty-Six Weeks Ended June 27, 2003 Compared to Twenty-Six Weeks Ended June 28, 2002

The following table compares the operating results for the twenty-six weeks ended June 27, 2003 and June 28, 2002 (in thousands):

|  | Twenty-Six Weeks Ended |                  |                   |
|--|------------------------|------------------|-------------------|
|  | June 27,<br>2003       | June 28,<br>2002 | Percent<br>Change |
| Revenue from services                        | \$ 387,964             | \$ 389,208       | (0.3)             |
| Cost of services                             | 272,093                | 277,487          | (1.9)             |
| Selling, general and administrative expenses | 106,587                | 106,629          | (0.0)             |
| Depreciation and amortization                | 4,115                  | 4,791            | (14.1)            |
| Interest and other expense, net              | (2,082)                | (541)            | 284.8             |
| Income (loss) before tax expense (benefit)   | 3,087                  | (240)            | 1,386.3           |
| Net income (loss)                            | \$ 2,006               | \$ (146)         | 1,474.0           |

**Dispatch Offices and Revenue from Services.** The number of offices increased to 790 at June 27, 2003 from 753 locations at June 28, 2002. Revenue for the first half of 2003 declined slightly by 0.3% as compared to the same period a year earlier. The change in revenue was made up of the following three components: (a) a 0.4% decline in same branch revenue, defined as those branches opened one year or longer, (b) a 60 basis point decline in revenue related to closing 28 branches since the second quarter of 2002 and (c) the 0.6% growth in revenue from new branches opened this year. Revenues from our international operations for the twenty-six weeks ended June 27, 2003 were approximately 6.0% of our total revenues compared to 5.2% for the same period last year.

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### **Cost of Services and Gross Margin.**

Cost of services decreased to 70.1% of revenue for the twenty-six weeks ended June 27, 2003 compared to 71.3% for the twenty-six weeks ended June 28, 2002. The decrease in cost of services as a percent of revenue is due to the fact that our average bill rate increased by nearly 2.2% during the twenty-six weeks ended June 27, 2003 over a year earlier while our average pay rate increased 0.3%. Additionally, workers' compensation expense as a percent of revenue declined to 7.5% from 7.9% a year earlier, as prior years' reserve balances stabilized. As a result, our gross margins were 29.9% for the twenty-six weeks ended June 27, 2003 compared to 28.7% for the twenty-six weeks ended June 28, 2002.

**Selling, General, and Administrative Expenses.** Selling, general and administrative ("SG&A") expenses have remained fairly consistent as we continue to make a company-wide concerted effort to reduce costs. SG&A expenses were 27.5% of revenue for the twenty-six weeks ended June 27, 2003 compared to 27.4% of revenue for the twenty-six weeks ended June 28, 2002.

**Depreciation and Amortization Expense.** Depreciation and amortization expenses have decreased to \$4.1 million for the first half of 2003 from \$4.8 million for the same period in 2002. The decrease is largely the result of a one-time adjustment for a change in the estimated useful lives of certain assets during the second quarter of 2002. Capital expenditures have decreased during the same periods to \$1.8 million in 2003 compared to \$2.2 million in 2002.

**Interest and Other Expense, Net.** We recorded interest and other expense, net of interest income, of (\$2.1) million for the twenty-six weeks ended June 27, 2003 as compared to (\$0.5) million for the twenty-six weeks ended June 28, 2002. The increase in interest expense in 2003 is a result of the interest on the 6.25% Convertible Subordinated Notes due 2007 (the "Notes") that were issued in June 2002.

**Taxes On Income.** Our effective tax rate was 35.0% for the twenty-six weeks ended June 27, 2003 compared to 39.2% for the twenty-six weeks ended June 28, 2002. The decrease in 2003 as compared to 2002 is largely a result of increased utilization of Work Opportunity, Welfare to Work and Empowerment Zone tax credits. The principal difference between the statutory federal income tax rate and our effective income tax rate results from state income taxes, federal credits, certain non-deductible expenses and the valuation allowance discussed below.

We have a net deferred tax asset of approximately \$26.1 million at June 27, 2003 resulting primarily from workers' compensation reserves and allowance for doubtful accounts. We have assessed our past earnings history and trends, projected sales, expiration dates of loss carry-forwards, and our ability to implement tax planning strategies which are designed to accelerate or increase taxable income. Based on the results of this analysis and the uncertainty of the realization of certain tax planning measures, we have established a valuation allowance against our carryforward benefits in the amount of \$3.5 million at June 27, 2003 and \$2.2 million at June 28, 2002.

### **Risk Factors: Issues and Uncertainties**

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

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

The short-term, light industrial niche of the temporary services industry is highly competitive, with limited barriers to entry. Several very large full-service and specialized temporary labor companies, as well as small local operations, compete with us in the staffing industry. Competition in some markets is intense, particularly for provision of light industrial personnel, and these competitive forces limit our ability to raise prices to our customers. For example, competitive forces have historically limited our ability to raise our prices to immediately and fully offset increased costs of doing business, including increased labor costs and increased costs for workers' compensation insurance. As a result of these forces, we have in the past faced pressure on our operating margins. Pressure on our margins has been intense since 2002. We cannot assure you that we will not continue to face pressures on our margins. If we are not able to effectively compete in our targeted markets, our operating margins and other financial results will be harmed and the price of our securities could decline.

#### **We have recently experienced a decline in annual revenue, and this trend may continue, which could cause the price of our securities to decline.**

We had revenue of \$862.7 million in 2002 compared to \$917.0 million in 2001 and \$976.6 million in 2000. The decline in revenue in 2001 and 2002 was primarily due to our consolidation of dispatch offices and a decrease in average revenue per dispatch office during the recent economic downturn. We cannot assure you that this decline in revenue will not continue or that our revenue and profits will not continue to be adversely affected by unfavorable economic conditions. Any continuation of these trends could cause the price of our securities to decline.

#### **If we are not able to obtain workers' compensation insurance on commercially reasonable terms, our financial condition or results of operations may suffer.**

We are required to pay workers' compensation benefits for our temporary workers and regular employees. We have seen a tightening insurance market that has resulted in significantly increased insurance costs and higher deductibles, including workers' compensation insurance. Under our workers' compensation insurance program, we maintain "per occurrence" insurance, which covers any claims for a particular event above a \$2.0 million deductible, and we do not maintain an aggregate stop-loss limit other than on a per-occurrence basis. While we have recently secured coverage for occurrences in July 2003 through June 2004, our insurance policies must be renewed annually, and we cannot guarantee that we will be able to successfully renew such policies for the coming year or any year thereafter.

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

We are required to maintain commitments such as irrevocable letters of credit, cash-backed instruments, or surety bonds to secure repayment to our insurance companies (or in some instances, the state) of the deductible portion of all open workers' compensation claims. We pledge cash or other assets in order to obtain irrevocable letters of credit. We sometimes face difficulties in recovering our collateral from insurers, particularly when those insurers are in financial distress, and we cannot guarantee that our collateral for past claims will be released in a timely manner as we pay down claims. As a result, we expect that the amount of collateral required to secure our commitments to our insurance carriers will increase. We believe that our current sources of liquidity will satisfy our immediate needs for these obligations; however, our currently available sources of collateral for these commitments are limited and we could be required to seek additional sources of capital in the future. These additional sources of financing may not be available on commercially reasonable terms. Even if they are available, these financings could result in dilution to our existing shareholders.

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

We maintain a reserve for workers' compensation claims using actuarial estimates of the future cost of claims and related expenses that have been reported but not settled, and that have been incurred but not reported. This reserve, which reflects potential liabilities that span several years, is discounted to its net present value using a discount rate of 5%. We evaluate the accrual rates for our reserves regularly throughout the year and make adjustments as needed. If the actual cost of such claims and related expenses exceed the amounts estimated, or if the discount rate represents an inflated estimate of our return on capital over time, actual losses for these claims may exceed reserves and/or additional reserves may be required. We also establish an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required

payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. We have also established reserves for contingent legal and regulatory liabilities, based on management's estimates and judgments of the scope and likelihood of these liabilities. We cannot assure you that our reserves are adequate. If the actual outcome of these matters is less favorable than expected, an adjustment would be charged to expense in the period in which the outcome occurs or the period in which our estimate changes.

***Some insurance companies with which we have previously done business are in financial distress. If our insurers do not fulfill their obligations, we could experience significant losses.***

We have purchased annual insurance policies in connection with our workers' compensation obligations from three primary carriers. Kemper Insurance Company provides coverage for occurrences in 2001, 2002 and the current year through June 30, 2003. Prior to 2001, Legion Insurance Company and Reliance Insurance Company provided coverage to us. These insurance carriers are experiencing unfavorable claims experience and loss of their own reinsurance coverage, and as a result, are in substantially weakened financial condition. To the extent that we experience claims that exceed our deductible limits and our insurers do not satisfy their coverage obligations, we may be forced to satisfy a portion of those claims directly; this in turn could harm our financial condition or results of operations. In addition, our insurance policies must be renewed annually, and we cannot guarantee that we will be able to successfully renew such policies for the coming year or any year thereafter.

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

Our credit facilities contain strict financial covenants. Among other things, these covenants require us to maintain certain net income and net worth levels and a certain ratio of net income to fixed expenses. In the past we have negotiated amendments to these covenants to ensure our continued compliance with their restrictions. We cannot assure you that our lender would consent to such amendments on commercially reasonable terms in the future if we once again required such relief. In the event that we do not comply with the covenants and the lender does not consent to such non-compliance, we will be in default of our agreement, which could subject us to penalty rates of interest and accelerate the maturity of the outstanding balances. Moreover, the indenture governing our Notes and a number of our smaller loan arrangements contain cross-default provisions, which accelerate our indebtedness under these arrangements in the event we default under our credit facilities. Accordingly, in the event of a default under our credit facilities, we could be required to seek additional sources of capital to satisfy our liquidity needs. These additional sources of financing may not be available on commercially reasonable terms. Even if they are available, these financings could result in dilution to our existing shareholders.

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

A significant portion of our revenue is derived from our operations in a limited number of states. Revenue generated from operations in California, Texas and Florida, in the aggregate, accounted for approximately 34.9% and 35.2% of our overall revenue in 2002 and 2001, respectively. The California economy has been particularly hard-hit by the most recent economic recession. California is our largest market and continued economic weakness in this region or our other key markets could harm our business.

***Any significant economic downturn could result in our clients using fewer temporary employees, which could harm our business.***

During 2001 and 2002 and so far in 2003, the slowdown in the U.S. economy significantly impacted the light industrial labor markets and has reduced our revenue. Because demand for personnel services and recruitment services is sensitive to changes in the level of economic activity, our business may suffer during economic downturns. As economic activity slows down, companies tend to reduce their use of temporary employees and recruitment services before undertaking layoffs of their regular employees, resulting in decreased demand for our personnel. As a result, any significant economic downturn could harm our business, financial condition or results of operations.

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

As of June 27, 2003, we had 46 dispatch offices in the United Kingdom and 36 in Canada. Establishing, maintaining and expanding our international operations expose us to a number of risks and expenses, including:

- substantially increased costs of operations;
- temporary diversion of existing management resources;
- establishment of an efficient and self-reliant local infrastructure;
- ability to deal effectively with local labor organizations and trade unions;
- ability to attract, hire and train qualified local sales and administrative personnel;
- compliance with additional local regulatory requirements;
- fluctuations in the value of foreign currencies;
- longer payment cycles;
- expansion of our information and control systems to manage expanded global operations; and
- the additional expense and risks inherent in operations in geographically and culturally diverse locations.

We cannot assure you that we will effectively deal with the challenges of expanding our foreign operations and our attempts to do so could harm our financial performance or results of operations.

***We may be exposed to employment-related claims and costs that could harm our business, financial condition or results of operations.***

We are in the business of employing people and placing them in the workplaces of other businesses. As a result, we are subject to a large number of federal and state regulations relating to employment. This creates a risk of potential claims of discrimination and harassment, violations of health and safety and wage and hour laws, criminal activity and other claims. From time to time we are subject to audit by various state and governmental authorities to determine our compliance with a variety of these regulations. We have in the past been found, and may in the future be found, to have violated regulations or other regulatory requirements applicable to our operations. We may, from time to time, incur fines and other losses or negative publicity with respect to any such violation. In addition, some or all of these claims may give rise to litigation, which could be time-consuming for our management.

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team, costly and could harm our business. We cannot assure you that we will not experience these problems in the future or that our insurance will be sufficient in amount or scope to cover any of these types of liabilities.

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

In 2003 and the past two years, a number of bills were introduced in Congress and various state legislatures which, if enacted, would impose conditions which could harm our business. This proposed legislation, much of which is backed by labor unions, has included provisions such as a requirement that our temporary workers receive the same pay and benefits as our customers' regular employees, prohibition on fees charged in connection with our CDMs and a requirement that our customers provide workers' compensation insurance for our temporary workers. We take a very active role and incur expense in opposing proposed legislation adverse to our business and in informing policy makers as to the social and economic benefits of our business. However, we cannot guarantee that any of these bills will not be enacted, in which event demand for our service may suffer.

Organized labor has sought to enact legislation in the State of California, our largest market. For example, legislation has been enacted in California that modifies the current

rules governing workers' compensation insurance in that state. Although the exact impact of this legislation on our business is unclear, this or other similar legislation in California or our other large markets could significantly increase our costs of doing business or decrease the value of our services to our customers. Either result could harm our results of operations.

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

We incur significant costs to comply with all applicable federal and state laws and regulations relating to employment, including occupational safety and health provisions, wage and hour requirements (including minimum wages), workers' compensation and unemployment insurance. We cannot assure you that we will be able to increase fees charged to our customers to offset increased costs relating to these laws and regulations. If we incur additional costs to comply with these regulations and we are not able to increase the rates we charge our customers to fully cover any such increase, our margins and operating results will be harmed.

***Our operations expose us to the risk of litigation, which we try to manage but could lead to significant potential liability.***

From time to time we are party to litigation in the ordinary course of our business. Moreover, certain labor unions have coordinated legal actions directed at us designed to further their own interests. The claimants in two current proceedings have aggregated claims as class actions. The costs of defense and the risk of loss in connection with class action suits are greater than in standard commercial litigation. We cannot assure you that such litigation will not disrupt our business or impact our financial results, due to the costs of defending against such litigation, any judgments that may be awarded against us and the loss of significant management time devoted to such litigation.

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

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

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

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

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

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

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

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

***Our business would suffer if we could not attract enough temporary workers.***

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

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

In five states, Canada and Puerto Rico, we pay workers' compensation insurance premiums directly to the government in amounts based in part on the classification of jobs performed by our workers. From time to time, we are subject to audits by various state regulators regarding our classifications of jobs performed by our workers. The classification of jobs performed by our workers is one of many factors taken into account by our actuaries in helping us determine the adequacy of our financial reserves for our workers' compensation exposure. If it is determined that we have materially misclassified a number of our workers, we could be required to increase our financial reserves for our workers' compensation liability, which could harm our results of operations and could cause the price of our securities to decline.

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

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

***Our dismissal of Arthur Andersen LLP could impair our ability to make timely SEC filings.***

Arthur Andersen LLP served as our independent auditor from 1997 until May 3, 2002, when our board of directors dismissed Andersen due to events that had cast doubt on Andersen's future. As a result of our termination of Andersen, we have retained the accounting firm of PricewaterhouseCoopers LLP to serve as our new independent accountants. Andersen can no longer provide us with representations relating to our historical financial statements for the year ending on December 31, 2001 and prior years. We cannot predict the impact of Andersen's failure to make the required representations and cannot assure you that our ability to make timely SEC filings will not be impaired. Furthermore, relief that may be available to investors under the federal securities laws against auditing firms may not be available as a practical matter against Andersen.

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

We are exposed to market risk related to changes in interest rates, and to a minor extent, foreign currency exchange rates, each of which could adversely affect the value of our investments. We do not currently use derivative financial instruments. At June 27, 2003, our purchased investments included in cash and cash equivalents had maturities of less than 90 days. Therefore, an increase in interest rates immediately and uniformly by 10% from levels at June 27, 2003 would not have a material effect upon our cash and

cash equivalent balances, operating results or cash flows.

At June 27, 2003, our marketable securities consist of revenue bonds and other municipal obligations, the vast majority of which have maturity dates of less than one year. Therefore, an increase in interest rates immediately and uniformly by 10% from levels at June 27, 2003 would not have a material effect upon our marketable securities balances, operating results or cash flows.

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

#### Item 4. Controls and Procedures

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our CEO and our CFO concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## PART II. Other Information

### Item 1. Legal Proceedings

See Note 7 of Notes to Consolidated Financial Statements found in Item 1 of Part I of this Form 10-Q.

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

At our Annual Meeting of Shareholders held on June 11, 2003, the following proposal was adopted by the margins indicated:

PROPOSAL 1: Annual Election of Directors. The nominees for election as directors were Robert J. Sullivan, Joseph P. Sambataro, Jr., Mark R. Beatty, Gates McKibbin, Thomas E. McChesney, Carl W. Schafer, and William W. Steele. Each of these nominees was reelected to serve for a one year term, by the following margins of votes:

| Nominees                 | For        | Withheld |
|--------------------------|------------|----------|
| Robert J. Sullivan       | 35,722,899 | 212,325  |
| Joseph P. Sambataro, Jr. | 35,720,595 | 214,629  |
| Mark R. Beatty           | 35,724,327 | 210,897  |
| Gates McKibbin           | 35,373,351 | 561,873  |
| Thomas E. McChesney      | 35,724,766 | 210,485  |
| Carl W. Schafer          | 35,727,485 | 207,739  |
| William W. Steele        | 35,728,235 | 206,989  |

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

#### a) Exhibits.

|                     |   |
|---------------------|---|
| <b>Exhibit 31.1</b> | Certification of Joseph P. Sambataro, Jr., Chief Executive Officer of Labor Ready, Inc., Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002         |
| <b>Exhibit 31.2</b> | Certification of Steven C. Cooper, Chief Financial Officer of Labor Ready, Inc., Pursuant to Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                 |
| <b>Exhibit 32.1</b> | Certification of Joseph P. Sambataro, Jr., Chief Executive Officer of Labor Ready, Inc., Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| <b>Exhibit 32.2</b> | Certification of Steven C. Cooper, Chief Financial Officer of Labor Ready, Inc., Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002         |

#### b) Reports on Form 8-K.

We filed a current report on Form 8-K on April 15, 2003, reporting under Item 9 – Regulation FD Disclosure, our financial results for the quarter ended March 28, 2003.

We filed a current report on Form 8-K on June 4, 2003, disclosing under Item 9 – Regulation FD Disclosure, copies of slide presentations, which we presented at the Lehman Brothers Global Services Conference on June 4, 2003 and generally to members of the financial and investment community from time to time.

We filed a current report on Form 8-K on June 10, 2003, updating under Item 9 – Regulation FD Disclosure, our previously released guidance for the second quarter of 2003 and announcing the departure of Matt Rodgers, executive vice president and chief operating officer of the Company.

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## SIGNATURES

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

LABOR READY, INC.



/s/ Joseph P. Sambataro, Jr. 8/4/03

Signature Date

By: Joseph P. Sambataro, Jr., Director, Chief  
Executive Officer and President

/s/ Steven C. Cooper 8/4/03

Signature Date

By: Steven C. Cooper, Chief Financial Officer and  
Executive Vice President

## CERTIFICATIONS

I, Joseph P. Sambataro, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Labor Ready, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 4, 2003

*[/s/ Joseph P. Sambataro, Jr.]*

Joseph P. Sambataro, Jr.  
Chief Executive Officer

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## CERTIFICATIONS

I, Steven C. Cooper, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Labor Ready, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 4, 2003

*/s/ Steven C. Cooper*

Steven C. Cooper  
Chief Financial Officer

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**CERTIFICATION PURSUANT TO**  
**18 U.S.C. SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Labor Ready, Inc. (the "Company") on Form 10-Q for the period ending June 27, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joseph P. Sambataro, Jr., Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to Labor Ready, Inc. and will be retained by Labor Ready, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

*/s/ Joseph P. Sambataro, Jr.*  
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Joseph P. Sambataro, Jr.  
Chief Executive Officer  
August 4, 2003

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**CERTIFICATION PURSUANT TO**  
**18 U.S.C. SECTION 1350,**  
**AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Labor Ready, Inc. (the "Company") on Form 10-Q for the period ending June 27, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven C. Cooper, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to Labor Ready, Inc. and will be retained by Labor Ready, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ Steven C. Cooper  
Steven C. Cooper  
Chief Financial Officer  
August 4, 2003

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