

BARRETT BUSINESS SERVICES INC
Form 10-Q
August 11, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 30, 2008

Commission File No. 0-21886

BARRETT BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Maryland (State or other jurisdiction of incorporation or organization) | 52-0812977 (IRS Employer Identification No.) |
| 8100 NE Parkway Drive, Suite 200 Vancouver, Washington (Address of principal executive offices) | 98662 (Zip Code) |
| (360) 828-0700 | |
| (Registrant's telephone number, including area code) | |

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

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

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

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

Number of shares of common stock, \$.01 par value, outstanding at July 31, 2008 was 10,740,089 shares.

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Part I - Financial Information

Item 1. Financial Statements

BARRETT BUSINESS SERVICES, INC.

Consolidated Balance Sheets

(Unaudited)

(In thousands, except per share amounts)

| | June 30, 2008 | December 31, 2007 |
|--|------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 16,640 | \$ 9,777 |
| Marketable securities | 30,098 | 50,364 |
| Trade accounts receivable, net | 45,296 | 36,673 |
| Prepaid expenses and other | 1,994 | 2,336 |
| Deferred income taxes | 3,271 | 3,138 |
| Workers compensation receivables for insured claims | 225 | 225 |
| Total current assets | 97,524 | 102,513 |
| Marketable securities | 7,755 | 4,772 |
| Goodwill, net | 45,316 | 41,508 |
| Property, equipment and software, net | 15,863 | 16,136 |
| Restricted marketable securities and workers compensation deposits | 3,896 | 2,750 |
| Other assets | 1,671 | 1,649 |
| Workers compensation receivables for insured claims | 3,490 | 3,896 |
| | \$ 175,515 | \$ 173,224 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,212 | \$ 1,516 |
| Accrued payroll, payroll taxes and related benefits | 37,855 | 33,553 |
| Income taxes payable | 527 | |
| Other accrued liabilities | 713 | 1,064 |
| Workers compensation claims liabilities | 7,037 | 6,031 |
| Workers compensation claims liabilities for insured claims | 225 | 225 |
| Safety incentives liability | 4,663 | 5,911 |
| Total current liabilities | 52,232 | 48,300 |
| Customer deposits | 687 | 752 |
| Long-term workers compensation claims liabilities | 4,926 | 4,021 |
| Long-term workers compensation claims liabilities for insured claims | 2,372 | 2,464 |
| Deferred income taxes | 3,269 | 3,268 |
| Deferred gain on sale and leaseback | 610 | 671 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value; 500,000 shares authorized; no shares issued and outstanding | | |
| Common stock, \$.01 par value; 20,500 shares authorized, 10,891 and 11,127 shares issued and outstanding | 109 | 111 |

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| | | |
|----------------------------|------------|------------|
| Additional paid-in capital | 34,702 | 38,418 |
| Other comprehensive loss | (1,716) | (1,516) |
| Retained earnings | 78,324 | 76,735 |
| | 111,419 | 113,748 |
| | \$ 175,515 | \$ 173,224 |

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BARRETT BUSINESS SERVICES, INC.

Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share amounts)

| | Three Months Ended June 30, | |
|--|--|-----------------|
| | 2008 | 2007 |
| Revenues: | | |
| Staffing services | \$ 40,604 | \$ 29,747 |
| Professional employer service fees | 31,579 | 34,139 |
| Total revenues | 72,183 | 63,886 |
| Cost of revenues: | | |
| Direct payroll costs | 29,943 | 22,416 |
| Payroll taxes and benefits | 20,721 | 20,542 |
| Workers compensation | 7,465 | 5,964 |
| Total cost of revenues | 58,129 | 48,922 |
| Gross margin | 14,054 | 14,964 |
| Selling, general and administrative expenses | 9,165 | 7,727 |
| Depreciation and amortization | 382 | 316 |
| Income from operations | 4,507 | 6,921 |
| Other income (expense): | | |
| Investment income, net | 535 | 808 |
| Other | 52 | (18) |
| Other income (expense) | 587 | 790 |
| Income before income taxes | 5,094 | 7,711 |
| Provision for income taxes | 1,844 | 2,830 |
| Net income | \$ 3,250 | \$ 4,881 |
| Basic earnings per share | \$.30 | \$.43 |
| Weighted average number of basic shares outstanding | 10,937 | 11,263 |
| Diluted earnings per share | \$.29 | \$.42 |
| Weighted average number of diluted shares outstanding | 11,221 | 11,690 |

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BARRETT BUSINESS SERVICES, INC.

Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share amounts)

| | Six Months Ended June 30, | |
|---|--------------------------------------|-----------------|
| | 2008 | 2007 |
| Revenues: | | |
| Staffing services | \$ 76,423 | \$ 57,762 |
| Professional employer service fees | 61,954 | 66,712 |
| Total revenues | 138,377 | 124,474 |
| Cost of revenues: | | |
| Direct payroll costs | 56,326 | 43,558 |
| Payroll taxes and benefits | 45,166 | 44,453 |
| Workers compensation | 14,269 | 11,808 |
| Total cost of revenues | 115,761 | 99,819 |
| Gross margin | 22,616 | 24,655 |
| Selling, general and administrative expenses | 17,834 | 15,115 |
| Depreciation and amortization | 758 | 665 |
| Income from operations | 4,024 | 8,875 |
| Other income (expense): | | |
| Interest expense | (3) | (2) |
| Investment income, net | 1,176 | 1,587 |
| Other | 40 | (10) |
| Other income (expense) | 1,213 | 1,575 |
| Income before provision for income taxes | 5,237 | 10,450 |
| Provision for income taxes | 1,896 | 3,841 |
| Net income | \$ 3,341 | \$ 6,609 |
| Basic earnings per share | \$.30 | \$.58 |
| Weighted average number of basic shares outstanding | 11,012 | 11,259 |
| Diluted earnings per share | \$.30 | \$.57 |
| Weighted average number of diluted shares outstanding | 11,322 | 11,686 |

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BARRETT BUSINESS SERVICES, INC.

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

| | Six Months Ended June 30, | |
|--|--------------------------------------|----------------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 3,341 | \$ 6,609 |
| Reconciliations of net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 758 | 665 |
| (Gains) losses recognized on marketable securities | (42) | 8 |
| Purchases of marketable securities | (31) | (2) |
| Gains recognized on sale and leaseback | (61) | (61) |
| Deferred income taxes | 2 | 1,523 |
| Changes in certain assets and liabilities, net of amounts purchased in acquisitions: | | |
| Trade accounts receivable, net | (8,623) | (5,578) |
| Prepaid expenses and other | 342 | (169) |
| Accounts payable | (304) | (218) |
| Accrued payroll, payroll taxes and related benefits | 4,302 | 1,416 |
| Income taxes payable | 527 | 847 |
| Other accrued liabilities | (351) | 421 |
| Workers' compensation claims liabilities | 2,225 | (1,606) |
| Safety incentives liability | (1,248) | 296 |
| Customer deposits and other assets, net | (101) | 122 |
| Net cash provided by operating activities | 736 | 4,273 |
| Cash flows from investing activities: | | |
| Cash paid for acquisitions, including other direct costs | (3,838) | (500) |
| Purchases of property and equipment, net of amounts purchased in acquisitions | (441) | (429) |
| Proceeds from sales and maturities of marketable securities | 72,378 | 61,193 |
| Purchases of marketable securities | (55,356) | (62,199) |
| Proceeds from maturities of restricted marketable securities | 1,693 | 1,807 |
| Purchases of restricted marketable securities | (2,839) | (1,847) |
| Net cash provided by (used in) investing activities | 11,597 | (1,975) |
| Cash flows from financing activities: | | |
| Proceeds from credit-line borrowings | 5,040 | 5,202 |
| Payments on credit-line borrowings | (5,040) | (5,202) |
| Proceeds from the exercise of stock options | 221 | 25 |
| Dividends paid | (1,752) | (1,577) |
| Repurchase of common stock | (3,997) | |
| Tax benefit of stock option exercises | 58 | 128 |
| Net cash used in financing activities | (5,470) | (1,424) |
| Net increase in cash and cash equivalents | 6,863 | 874 |
| Cash and cash equivalents, beginning of period | 9,777 | 23,071 |

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| | | |
|--|-----------|-----------|
| Cash and cash equivalents, end of period | \$ 16,640 | \$ 23,945 |
| Supplemental schedule of noncash investing activities: | | |
| Acquisition of other businesses: | | |
| Cost of acquisitions in excess of fair market value of net assets acquired | \$ 3,808 | \$ 500 |
| Intangible assets acquired | 15 | |
| Tangible assets acquired | 15 | |
| Net cash paid for acquisitions | \$ 3,838 | \$ 500 |

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited)

Note 1 - Basis of Presentation of Interim Period Statements

The accompanying consolidated financial statements are unaudited and have been prepared by Barrett Business Services, Inc. (Barrett , BBSI or the Company), pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures typically included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods presented. The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from such estimates and assumptions. The consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s 2007 Annual Report on Form 10-K at pages F1- F24. The results of operations for an interim period are not necessarily indicative of the results of operations for a full year.

Effective January 1, 2007, the Company formed a wholly owned captive insurance company, Associated Insurance Company for Excess (AICE). AICE is a fully licensed captive insurance company holding a certificate of authority from the Arizona Department of Insurance. The purpose of AICE is twofold: (1) to provide access to more competitive and cost effective insurance markets and (2) to provide additional flexibility in cost effective risk management. The captive principally provides coverage for workers compensation claims occurring on or after January 1, 2007. During the second quarter of 2007, AICE began to provide general liability insurance coverage for BBSI on an as requested basis by third parties such as customers, landlords and other vendors.

Financial Statement Reclassification

Certain prior year amounts have been reclassified to present variable rate demand notes (VRDN) and municipal bonds as short-term investments instead of cash and cash equivalents. The Company has revised its consolidated balance sheet for the year ended December 31, 2007 and its consolidated statements of cash flows for the six month period ended June 30, 2007. As a result, the Company s investments in VRDN and municipal bonds in the amount of \$53.0 million at December 31, 2007, which had previously been included in cash and cash equivalents, are presented as investments in the accompanying consolidated balance sheet at December 31, 2007. As a result of this reclassification, the aggregate purchases and proceeds from the sale of these securities for the six month period ended June 30, 2007 will be presented in the consolidated statements of cash flows from investing activities. These reclassifications had no impact on the Company s results of operations, changes in shareholders equity, or cash flows from operating activities and financing activities.

Our investments in municipal bonds generally consist of bonds from highly rated issuers that are within one to two years of maturity. VRDN are instruments bundled with long-term municipal bonds from highly rated issuers that are traded at par value with an interest rate reset weekly at varying intervals. These instruments include provisions whereby the Company can put the instrument back to the issuer.

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

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

The Company had historically classified VRDN and municipal bonds as cash and cash equivalents which was based on the Company's ability to liquidate its holdings on short notice and the limited exposure to market volatility of these investments. While our investment strategy continues to emphasize liquidity and close management of market risk, we believe these reclassifications provide greater transparency as to the components of our short-term investments. The effects of these reclassifications are summarized in the table below.

| (in thousands) | Three Months Ended March 31, 2008 | | Three Months Ended March 31, 2007 | | Six Months Ended June 30, 2007 | |
|---|---------------------------------------|--------------------|--------------------------------------|--------------------|-----------------------------------|--------------------|
| | As Originally Reported | As Reclassified | As Originally Reported | As Reclassified | As Originally Reported | As Reclassified |
| | Cash flows from investing activities: | | | | | |
| Purchases of marketable securities | \$ | \$ (45,392) | \$ (729) | \$ (28,375) | \$ (729) | \$ (62,199) |
| Proceeds from sales and maturities of marketable securities | | 45,015 | | 25,575 | | 61,193 |
| Net cash used in investing activities | (4,430) | (4,807) | (1,540) | (3,611) | (1,698) | (1,975) |
| Net (decrease) increase in cash and cash equivalents | (7,873) | (8,250) | (167) | (2,238) | 1,151 | 874 |
| Cash and cash equivalents, beginning of period | 62,779 | 9,777 | 69,874 | 23,071 | 69,874 | 23,071 |
| Cash and cash equivalents, end of period | 54,906 | 1,527 | 69,707 | 20,833 | 71,025 | 23,945 |
| Current marketable securities, end of period | 1,458 | 44,002 | 3,845 | 45,377 | 3,625 | 43,514 |
| Long-term marketable securities, end of period | 419 | 11,254 | 409 | 7,751 | 411 | 7,602 |

Marketable Securities

As of June 30, 2008, the Company's marketable securities consisted of tax-exempt municipal securities, Variable Rate Demand Notes (VRDN), closed-end bond funds, equity securities and corporate bonds. The Company classifies municipal securities, VRDN and the closed-end bond funds as available for sale; they are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of other comprehensive income (loss) in stockholders' equity. The equity securities are classified as trading and are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of net income. The corporate bonds are classified as held-to-maturity and are reported at amortized cost.

Allowance for doubtful accounts

The Company had an allowance for doubtful accounts of \$249,000 and \$100,000 at June 30, 2008 and December 31, 2007, respectively. The Company must make estimates of the collectibility of accounts receivables. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic conditions and changes in customers' payment trends when evaluating the adequacy of the allowance for doubtful accounts. The Company deems an account balance uncollectible only after it has pursued all available assets of the customer and, where applicable, the assets of the personal guarantor.

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BARRETT BUSINESS SERVICES, INC.

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

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

Workers' compensation claims

The Company is a self-insured employer with respect to workers' compensation coverage for all of its employees (including employees subject to Professional Employer Organization (PEO) contracts) working in California, Oregon, Maryland and Delaware. In the state of Washington, state law allows only the Company's staffing services and internal management employees to be covered under the Company's self-insured workers' compensation program. To manage our financial exposure, in the event of catastrophic injuries or fatalities, we maintain excess workers' compensation insurance (through our captive insurance company) with a per occurrence retention of \$5.0 million, except in Maryland, where our per occurrence retention is \$1.0 million effective January 1, 2007. AICE maintains excess workers' compensation insurance coverage with AIG between \$5.0 million and \$15.0 million per occurrence, except in Maryland, where coverage with AIG is between \$1.0 million and \$25.0 million per occurrence.

The Company has provided a total of \$14.6 million and \$12.7 million at June 30, 2008 and December 31, 2007, respectively, as an estimated future liability for unsettled workers' compensation claims liabilities. Included in the foregoing liabilities are insured claims that will be paid by the Company's former excess workers' compensation insurer and for which the Company has reported a receivable from the insurer for the insured claims liability. Insured claims totaled \$2.6 million and \$2.7 million at June 30, 2008 and December 31, 2007, respectively. The estimated liability for unsettled workers' compensation claims represents management's best estimate, which includes an evaluation of information provided by the Company's internal claims adjusters and our third-party administrators for workers' compensation claims, coupled with management's evaluations of historical claims development and conversion factors and other trends. Included in the claims liabilities are case reserve estimates for reported losses, plus additional amounts based on projections for incurred but not reported claims and anticipated increases in case reserve estimates. These estimates are continually reviewed and adjustments to liabilities are reflected in current operating results as they become known.

Safety incentives liability

Safety incentives represent cash incentives paid to certain PEO client companies for maintaining safe-work practices in order to minimize workplace injuries, thereby meeting certain established loss objectives. The Company has provided \$4.7 million and \$5.9 million at June 30, 2008 and December 31, 2007, respectively, as an estimated future liability for safety incentives. The incentive is based on a percentage of annual payroll and is paid annually to customers who meet predetermined workers' compensation claims cost objectives. Safety incentive payments are made only after closure of all workers' compensation claims incurred during the customer's contract period. The liability is estimated and accrued each month based upon the incentive earned less the then-current amount of the customer's estimated workers' compensation claims reserves as established by the Company's internal and third-party claims administrators.

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BARRETT BUSINESS SERVICES, INC.

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

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

Comprehensive income (loss)

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

Note 2 Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of SFAS 157 has not had a material effect on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, (SFAS 159). This statement gives the Company the option to elect to carry certain financial assets and liabilities at fair value with change in fair value recorded in earnings. The adoption of SFAS 159 effective January 1, 2008 has not had a material effect on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R) Business Combinations, (SFAS 141(R)). SFAS No. 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the potential impact of SFAS No. 141(R) on our consolidated financial statements.

Note 3 Acquisitions

Effective February 4, 2008, the Company acquired certain assets of First Employment Services, Inc., a privately held staffing company with offices in Tempe and Phoenix, Arizona. The Company paid \$3.8 million in cash upon closing and agreed to pay additional consideration of \$1.2 million in cash contingent upon the first 12 months of financial performance. The transaction resulted in the recognition of \$3.8 million of goodwill, \$15,000 of other assets and \$15,000 of fixed assets. The Company's consolidated income statements for the six months ended June 30, 2008 include First Employment's results of operations since February 4, 2008.

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) *(Continued)***Note 3 Acquisitions (Continued)**

Effective December 3, 2007, we acquired certain assets of Phillips Temps, Inc., a privately held staffing company with an office in downtown Denver, Colorado. The Company paid \$1.6 million in cash for the assets of Phillips Temps and the selling shareholders' noncompete agreements. There was no contingent consideration. The transaction resulted in the recognition of \$1.6 million of goodwill, \$20,000 of other assets and \$8,000 of fixed assets.

Effective July 2, 2007, the Company acquired certain assets of Strategic Staffing, Inc., a privately held staffing services company with five offices in Utah and one office in Colorado Springs, Colorado. The Company paid \$12.0 million in cash for the assets of Strategic Staffing and the selling shareholders' noncompete agreements and agreed to pay additional consideration contingent upon the first 12 months of financial performance. Management expects to complete the evaluation of the financial performance criteria for the 12 month period during the third quarter of 2008. The transaction to date resulted in the recognition of \$11.9 million of goodwill, \$60,000 of intangible assets and \$117,000 of fixed assets.

Note 4 Basic and Diluted Earnings Per Share

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------|------------------|------------|
| | June 30, | | June 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Weighted average number of basic shares outstanding | 10,936,871 | 11,262,664 | 11,011,865 | 11,258,870 |
| Stock option plan shares to be issued at prices ranging from \$2.00 to \$17.50 per share | 670,014 | 729,713 | 686,840 | 733,507 |
| Less: Assumed purchase at average market price during the period using proceeds received upon exercise of options and purchase of stock, and using tax benefits of compensation due to premature dispositions | (386,049) | (301,961) | (376,549) | (306,864) |
| Weighted average number of diluted shares outstanding | 11,220,836 | 11,690,416 | 11,322,156 | 11,685,513 |

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) *(Continued)***Note 5 Stock Incentive Plans and Stock-Based Compensation**

The Company's 2003 Stock Incentive Plan (the 2003 Plan), which provides for stock-based awards to Company employees, non-employee directors and outside consultants or advisors, was approved by shareholders on May 14, 2003. No options have been issued to outside consultants or advisors. The number of shares of common stock reserved for issuance under the 2003 Plan is 600,000. No new grants of stock options may be made under the Company's 1993 Stock Incentive Plan (the 1993 Plan). At June 30, 2008, there were option awards covering 202,739 shares outstanding under the 1993 Plan, which, to the extent they are terminated unexercised, will be carried over to the 2003 Plan as shares authorized to be issued under the 2003 Plan. Outstanding options under both plans generally expire ten years after the date of the grant. They were generally exercisable in four equal annual installments beginning one year after the date of grant; however, effective with the close of business on December 30, 2005, the compensation committee of the board of directors accelerated the vesting of all outstanding stock options.

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

The following table summarizes options activity in 2008:

| | Number of Options | Grant Prices |
|--------------------------------------|-------------------------|---------------------|
| Outstanding at December 31, 2007 | 706,591 | \$ 2.00 to \$ 17.50 |
| Options granted | 10,000 | \$11.97 |
| Options exercised | (145,273) | \$ 2.00 to \$ 9.87 |
| Options cancelled or expired | | |
| Outstanding at June 30, 2008 | 571,318 | \$ 2.00 to \$ 17.50 |
| Exercisable at June 30, 2008 | 561,318 | |
| Available for grant at June 30, 2008 | 83,877 | |

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

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

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

| (in thousands, except share data) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|--------|------------------------------|--------|
| | 2008 | 2007 | 2008 | 2007 |
| Intrinsic value of options exercised in the period | \$ 998 | \$ 243 | \$ 1,056 | \$ 323 |

| | As of June 30, | |
|--|----------------|------------|
| | 2008 | 2007 |
| Stock options: | | |
| Number of options | 571,318 | 723,894 |
| Options fully vested and currently exercisable | 561,318 | 723,894 |
| Weighted average exercise price | \$ 7.86 | \$ 7.19 |
| Aggregate intrinsic value | \$ 3,038 | \$ 13,491 |
| Weighted average contractual term of options | 5.57 years | 6.26 years |

The fair value of the stock-based awards, as determined under the Black-Scholes model, granted in the three months ended June 30, 2008, was estimated with the following weighted-average assumptions:

| | Three Months Ended June 30, 2008 |
|-------------------------|-------------------------------------|
| Risk-free interest rate | 1.7% |
| Expected dividend yield | 2.7% |
| Expected term | 7.27 years |
| Expected volatility | 61.5% |

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BARRETT BUSINESS SERVICES, INC.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

Note 6 Workers Compensation

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Beginning balance | | | | |
| Workers compensation claims liabilities | \$ 13,118 | \$ 11,379 | \$ 12,741 | \$ 12,374 |
| Add: claims expense accrual | 4,456 | 2,002 | 7,994 | 3,811 |
| Less: claim payments related to: | | | | |
| Current year | 736 | 735 | 894 | 772 |
| Prior years | 2,278 | 2,261 | 5,281 | 5,028 |
| Total paid | 3,014 | 2,996 | 6,175 | 5,800 |
| Ending balance | | | | |
| Workers compensation claims liabilities | \$ 14,560 | \$ 10,385 | \$ 14,560 | \$ 10,385 |

Note 7 Fair Value Measurement

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

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

| | June 30, 2008 | | | December 31, 2007 | | |
|----------------------------|---------------|--|------------|-------------------|--|------------|
| | Cost | Gross Unrealized Gains (Losses) | Fair Value | Cost | Gross Unrealized Gains (Losses) | Fair Value |
| Current: | | | | | | |
| Trading: | | | | | | |
| Equity securities | \$ 281 | \$ (31) | \$ 250 | \$ 249 | \$ (72) | \$ 177 |
| Available-for-sale: | | | | | | |
| Municipal bonds | 26,528 | 76 | 26,604 | 18,349 | | 18,349 |
| Variable rate demand notes | 2,134 | | 2,134 | 30,298 | | 30,298 |
| Closed-end bond funds | 3,995 | (2,885) | 1,110 | 3,995 | (2,455) | 1,540 |
| | \$ 32,938 | \$ (2,840) | \$ 30,098 | \$ 52,891 | \$ (2,527) | \$ 50,364 |

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| | | | | | | |
|---------------------|----------|-------|----------|----------|----|----------|
| Long-term: | | | | | | |
| Available-for-sale: | | | | | | |
| Municipal bonds | \$ 7,317 | \$ 16 | \$ 7,333 | \$ 4,355 | \$ | \$ 4,355 |
| Held-to-maturity: | | | | | | |
| Corporate bonds | 422 | | 422 | 417 | | 417 |
| | \$ 7,739 | \$ 16 | \$ 7,755 | \$ 4,772 | \$ | \$ 4,772 |

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BARRETT BUSINESS SERVICES, INC.

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

Note 7 Fair Value Measurement (Continued)

The continuing dislocation in the credit markets has exacerbated a decline in the current market value of a certain portion of the Company's investment portfolio allocated to four closed-end bond funds to an amount below the original investment of \$4.0 million. Management currently views the decrement in value to be temporary in nature due to market conditions, coupled with the continuing financial performance of the underlying securities and the Company's ability to continue to hold the bond funds. If the decline in value is determined in the future to be other than temporary, the Company could be required to record a material impairment charge.

Note 8 Subsequent Event

The Company entered into a new credit agreement (the Credit Agreement) with its principal bank effective July 1, 2008. The Credit Agreement provides for an unsecured revolving credit facility of up to \$7.0 million, which includes a subfeature under the line of credit for standby letters of credit up to \$7.0 million. The interest rate on advances, if any, will be, at the Company's discretion, either (i) equal to the prime rate or (ii) LIBOR plus 1.50%. The financial covenants require the Company to maintain an annual net income of one dollar and a quarterly pre-tax profit of one dollar.

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BARRETT BUSINESS SERVICES, INC.

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

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

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

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

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

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

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

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

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

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BARRETT BUSINESS SERVICES, INC.

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

The following table sets forth the percentages of total revenues represented by selected items in the Company's Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007.

| | Percentage of Total Revenues | | | |
|--|--|-------|--------------------------------------|-------|
| | Three Months Ended June 30, 2008 | | Six Months Ended June 30, 2007 | |
| Revenues: | | | | |
| Staffing services | 56.3% | 46.6% | 55.2% | 46.4% |
| Professional employer service fees | 43.7 | 53.4 | 44.8 | 53.6 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of revenues: | | | | |
| Direct payroll costs | 41.5 | 35.1 | 40.7 | 35.0 |
| Payroll taxes and benefits | 28.7 | 32.2 | 32.7 | 35.7 |
| Workers' compensation | 10.3 | 9.3 | 10.3 | 9.5 |
| Total cost of revenues | 80.5 | 76.6 | 83.7 | 80.2 |
| Gross margin | 19.5 | 23.4 | 16.3 | 19.8 |
| Selling, general and administrative expenses | 12.7 | 12.1 | 12.9 | 12.2 |
| Depreciation and amortization | 0.5 | 0.5 | 0.5 | 0.5 |
| Income from operations | 6.3 | 10.8 | 2.9 | 7.1 |
| Other income | 0.8 | 1.2 | 0.9 | 1.3 |
| Pretax income | 7.1 | 12.0 | 3.8 | 8.4 |
| Provision for income taxes | 2.6 | 4.4 | 1.4 | 3.1 |
| Net income | 4.5% | 7.6% | 2.4% | 5.3% |

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

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

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

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relationships, an increase in staffing revenues and related costs presented at gross dilutes the impact of the net PEO revenue on gross margin percentage.

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

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BARRETT BUSINESS SERVICES, INC.

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

| (in thousands) | Unaudited Three Months Ended | | Unaudited Six Months Ended | |
|--------------------------------|---------------------------------|------------------|-------------------------------|------------------|
| | June 30, 2008 | June 30, 2007 | June 30, 2008 | June 30, 2007 |
| Revenues: | | | | |
| Staffing services | \$ 40,604 | \$ 29,747 | \$ 76,423 | \$ 57,762 |
| Professional employer services | 228,891 | 237,957 | 452,652 | 467,470 |
| Total revenues | 269,495 | 267,704 | 529,075 | 525,232 |
| Cost of revenues: | | | | |
| Direct payroll costs | 225,887 | 224,605 | 443,740 | 441,233 |
| Payroll taxes and benefits | 20,721 | 20,542 | 45,166 | 44,453 |
| Workers' compensation | 8,833 | 7,593 | 17,553 | 14,891 |
| Total cost of revenues | 255,441 | 252,740 | 506,459 | 500,577 |
| Gross margin | \$ 14,054 | \$ 14,964 | \$ 22,616 | \$ 24,655 |

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

| (in thousands) | Gross Revenue Reporting Method | | Unaudited Three Months Ended June 30, Reclassification | | Net Revenue Reporting Method | |
|--------------------------------|-----------------------------------|-------------------|--|---------------------|---------------------------------|------------------|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Revenues: | | | | | | |
| Staffing services | \$ 40,604 | \$ 29,747 | \$ | \$ | \$ 40,604 | \$ 29,747 |
| Professional employer services | 228,891 | 237,957 | (197,312) | (203,818) | 31,579 | 34,139 |
| Total revenues | \$ 269,495 | \$ 267,704 | \$ (197,312) | \$ (203,818) | \$ 72,183 | \$ 63,886 |
| Cost of revenues | \$ 255,441 | \$ 252,740 | \$ (197,312) | \$ (203,818) | \$ 58,129 | \$ 48,922 |

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

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BARRETT BUSINESS SERVICES, INC.

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

| (in thousands) | Unaudited Six Months Ended June 30, | | | | | |
|--------------------------------|--|------------|------------------|--------------|---------------------------------|------------|
| | Gross Revenue Reporting Method | | Reclassification | | Net Revenue Reporting Method | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Revenues: | | | | | | |
| Staffing services | \$ 76,423 | \$ 57,762 | \$ | \$ | \$ 76,423 | \$ 57,762 |
| Professional employer services | 452,652 | 467,470 | (390,668) | (400,758) | 61,954 | 66,712 |
| Total revenues | \$ 529,075 | \$ 525,232 | \$ (390,668) | \$ (400,758) | \$ 138,377 | \$ 124,474 |
| Cost of revenues | \$ 506,459 | \$ 500,577 | \$ (390,668) | \$ (400,758) | \$ 115,761 | \$ 99,819 |

Three months ended June 30, 2008 and 2007

Net income for the second quarter of 2008 amounted to \$3.3 million, a decline of 33.4% or \$1.6 million from net income of \$4.9 million for the second quarter of 2007. The decline for the second quarter of 2008 was primarily due to lower gross margin dollars as a result of higher direct payroll costs and higher workers' compensation expense and to higher selling, general and administrative expenses. Diluted earnings per share for the second quarter of 2008 were \$.29 compared to \$.42 for the comparable 2007 period.

Revenues for the second quarter of 2008 totaled \$72.2 million, an increase of approximately \$8.3 million or 13.0%, which reflects an increase in the Company's staffing services revenue, partially offset by a decrease in PEO service fee revenue. Staffing services revenue increased approximately \$10.9 million or 36.5% over the comparable 2007 quarter primarily due to the three acquisitions made since July 2007. On a comparable branch office basis, i.e. without the effect of the three acquisitions, staffing services revenues for the second quarter declined 5.4% or approximately \$1.6 million from the comparable quarter in 2007. The decline in staffing services revenue was attributable to general economic conditions affecting our customers' business. Management expects demand for the Company's staffing services will continue to reflect overall economic conditions in its market areas. PEO service fee revenue decreased approximately \$2.6 million or 7.5% from the 2007 second quarter primarily due to a decline in business with existing PEO customers, offset in part by the net effect from the addition of new customers. General economic conditions continue to adversely affect the growth of our existing PEO customer base.

Gross margin for the second quarter of 2008 totaled approximately \$14.1 million, which represented a decrease of \$910,000 or 6.1% from the second quarter of 2007, primarily due to higher direct payroll costs and higher workers' compensation costs in terms of total dollars and as a percentage of revenues. The gross margin percent decreased from 23.4% of revenues for the second quarter of 2007 to 19.5% for the second quarter of 2008. The increase in direct payroll costs, as a percentage of revenues, from 35.1% for the second quarter of 2007 to 41.5% for the second quarter of 2008 reflects the shift in the overall mix of services from PEO services

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BARRETT BUSINESS SERVICES, INC.

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

Results of Operations (Continued)

Three months ended June 30, 2008 and 2007 (Continued)

to staffing services in the Company's customer base primarily resulting from the three acquisitions made since July 2007 and the effect of each customer's unique mark-up percent. Workers' compensation expense, as a percent of revenues, increased from 9.3% in the second quarter of 2007 to 10.3% in the second quarter of 2008. Workers' compensation expense for the second quarter of 2008 totaled \$7.5 million, compared to \$6.0 million for the second quarter of 2007. This increase was primarily due to higher estimates for new claim costs in states where the Company is self-insured and to higher insurance premiums in states where the Company is not self-insured. The decrease in payroll taxes and benefits, as a percentage of revenues, from 32.2% for the second quarter of 2007 to 28.7% for the second quarter of 2008, was largely due to the effect of growth in staffing services, offset in part by higher effective state unemployment tax rates in various states in which the Company operates as compared to the second quarter of 2007.

Selling, general and administrative (SG&A) expenses for the second quarter of 2008 amounted to approximately \$9.2 million, an increase of \$1.4 million or 18.6% over the second quarter of 2007. The increase over the second quarter of 2007 was primarily attributable to the incremental SG&A expense associated with the three acquisitions made since July 2007, which represented \$1.5 million, partially offset by a \$62,000 or .8% decrease in comparable branch operating expenses resulting from the similar level of business in the second quarter of 2008 compared to the same quarter of 2007. SG&A expenses, as a percentage of revenues, increased from 12.1% in the second quarter of 2007 to 12.7% in the second quarter of 2008.

Other income for the second quarter of 2008 was \$587,000 compared to \$790,000 for the second quarter of 2007. The decline in other income for the second quarter of 2008 was primarily attributable to decreased investment income earned on the Company's cash and investments.

Six months ended June 30, 2008 and 2007

Net income for the six months ended June 30, 2008 amounted to \$3.3 million, a decline of 49.4% or \$3.3 million from net income of \$6.6 million for the comparable period of 2007. The decline for the first six months of 2008 was primarily due to lower gross margin dollars as a result of higher direct payroll costs and higher workers' compensation expense and to higher selling, general and administrative expenses. Diluted earnings per share for the first six months of 2008 were \$.30 compared to \$.57 for the comparable 2007 period.

Revenues for the six months ended June 30, 2008 totaled \$138.4 million, an increase of approximately \$13.9 million or 11.2%, which reflects an increase in the Company's staffing services revenue, partially offset by a decrease in PEO service fee revenue. Staffing services revenue increased approximately \$18.7 million or 32.3% over the comparable 2007 period primarily due to the three acquisitions made since July 2007. On a comparable branch office basis, i.e. without the effect of the three acquisitions, staffing services revenues for the six months ended June 30, 2008 declined 8.4% from the comparable period in 2007. The decline

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BARRETT BUSINESS SERVICES, INC.

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

Results of Operations (Continued)

Six months ended June 30, 2008 and 2007 (Continued)

in comparable branch office staffing services revenue was attributable to general economic conditions affecting our customers' business. PEO service fee revenue decreased approximately \$4.8 million or 7.1% from the 2007 period primarily due to a decline in business with existing PEO customers, partially offset by the net effect from the addition of new customers. General economic conditions continue to have a softening effect on the business levels of our existing PEO customer base.

Gross margin for the six months ended June 30, 2008 totaled approximately \$22.6 million, which represented a decrease of \$2.0 million or 8.3% from the comparable period of 2007, primarily due to higher direct payroll costs and higher workers' compensation costs in terms of total dollars and as a percentage of revenues. The gross margin percent decreased from 19.8% of revenues for the first six months of 2007 to 16.3% for the first six months of 2008. The increase in direct payroll costs, as a percentage of revenues, from 35.0% for the first six months of 2007 to 40.7% for the first six months of 2008 reflects the shift in the overall mix of services from PEO services to staffing services in the Company's customer base primarily resulting from the three acquisitions made since July 2007 and the effect of each customer's unique mark-up percent. Workers' compensation expense, as a percent of revenues, increased from 9.5% in the first six months of 2007 to 10.3% in the first six months of 2008. Workers' compensation expense for the second quarter of 2008 totaled \$14.3 million, compared to \$11.8 million for the first six months of 2007. This increase was primarily due to higher estimates for new claim costs in states where the Company is self-insured as well as to higher insurance premiums in states where the Company is not self-insured. The decrease in payroll taxes and benefits, as a percentage of revenues, from 35.7% for the first six months of 2007 to 32.7% for the six months of 2008, was largely due to the effect of growth in staffing services, offset in part by higher effective state unemployment tax rates in various states in which the Company operates as compared to the first six months of 2007.

Selling, general and administrative (SG&A) expenses for the first six months of 2008 amounted to approximately \$17.8 million, an increase of \$2.7 million or 18.0% over the first six months of 2007. The increase over the first six months of 2007 was primarily attributable to the incremental SG&A expense associated with the three acquisitions made since July 2007, which represented \$2.9 million, partially offset by a \$212,000 or 1.4% decrease in comparable branch operating expenses resulting from the similar level of comparable branch business in the first six months of 2008 compared to the same period of 2007. SG&A expenses, as a percentage of revenues, increased from 12.2% in the first six months of 2007 to 12.9% in the first six months of 2008.

Other income for the first six months of 2008 was \$1.2 million compared to \$1.6 million for the comparable period of 2007. The decline in other income for the first six months of 2008 was primarily attributable to decreased investment income earned on the Company's cash and investment balances.

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BARRETT BUSINESS SERVICES, INC.

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

Factors Affecting Quarterly Results

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

Liquidity and Capital Resources

The Company's cash position for the six months ended June 30, 2008 increased \$6.9 million over December 31, 2007, which compares to an increase of \$874,000 for the comparable period in 2007. The increase in cash at June 30, 2008 as compared to December 31, 2007, was primarily due to proceeds from sales and maturities of marketable securities of \$72.4 million, offset in part by purchases of marketable securities of \$55.4 million, an increase of \$8.6 million in trade accounts receivable, and the Company's repurchase of its common stock of \$4.0 million.

Net cash provided by operating activities for the six months ended June 30, 2008 amounted to \$736,000, compared to \$4.3 million for the comparable 2007 period. For the six months ended June 30, 2008, cash flow was principally provided by net income of \$3.3 million, an increase of \$4.3 million in accrued payroll and benefits and an increase of \$2.2 million in workers' compensation claims liabilities, offset in part by an increase in trade accounts receivable of \$8.6 million.

Net cash provided by investing activities totaled \$11.6 million for the six months ended June 30, 2008, compared to cash used in investing activities of \$2.0 million for the similar 2007 period. For the 2008 period, cash from investing activities was principally provided by the proceeds totaling \$72.4 million from maturities of marketable securities, offset in part by purchases of \$55.4 million of marketable securities, cash used in the acquisition of First Employment Services of \$3.8 million, and the net purchases of restricted marketable securities of \$1.1 million. The transactions related to restricted marketable securities are typically for scheduled maturities and the related replacement of such securities held for workers' compensation surety deposit purposes. The Company presently has no material long-term capital commitments.

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BARRETT BUSINESS SERVICES, INC.

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

Liquidity and Capital Resources (Continued)

Net cash used in financing activities for the six-month period ended June 30, 2008 was \$5.5 million as compared to \$1.4 million for the similar 2007 period. For the 2008 period, the principal use of cash for financing activities was the Company's repurchase of its common stock of \$4.0 million and the payment of regular quarterly cash dividends totaling \$1.8 million to holders of the Company's Common Stock.

As disclosed in Note 3 to the consolidated financial statements included in this report, the Company acquired certain assets of Strategic Staffing, Inc., a privately held staffing services company with five offices in Utah and one office in Colorado Springs, Colorado, effective July 2, 2007. The Company paid \$12.0 million in cash on the effective date for the assets of Strategic Staffing and the selling shareholders' non-compete agreements and agreed to pay additional consideration based upon the level of financial performance achieved by the Strategic Staffing offices during the ensuing 12-month period. Management expects to complete the evaluation of the financial performance criteria for the 12 month period during the third quarter of 2008. Management currently estimates the additional consideration could be as much as \$2.0 million. The Company also acquired certain assets of Phillips Temps, Inc., a privately held staffing services company with an office in downtown Denver, Colorado, effective December 3, 2007. The Company paid \$1.3 million in cash for the assets of Phillips Temps and the selling shareholders' noncompete agreements and paid an additional \$300,000 on March 3, 2008. There was no contingent consideration.

Also, as disclosed in Note 3 to the consolidated financial statements in this report, the Company acquired certain assets of First Employment Services, Inc., a privately held staffing services company with offices in Tempe and Phoenix, Arizona, effective February 4, 2008. As consideration for the acquisition, the Company paid \$3.8 million in cash and agreed to pay additional consideration of \$1.2 million contingent upon the first 12 months of financial performance. For 2007, First Employment's revenues were approximately \$7.5 million. Management anticipates that this acquisition may increase earnings by approximately 3 to 4 cents per diluted share for the 12-month period following the effective date.

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

The Company was in compliance with all covenants at June 30, 2008 for the bank credit agreement that expired on that date. The Company entered into a new credit agreement (the "Credit Agreement") with its principal bank effective July 1, 2008. The Credit Agreement provides for an unsecured revolving credit facility of up to \$7.0 million, which includes a subfeature under the line of credit for standby letters of credit up to \$7.0 million. The interest rate on advances, if any, will be, at the Company's discretion, either (i) equal to the prime rate or (ii) LIBOR plus 1.50%. The Credit Agreement expires July 1, 2009.

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BARRETT BUSINESS SERVICES, INC.

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

Liquidity and Capital Resources (Continued)

Pursuant to the Credit Agreement, the Company is required to maintain compliance with the following covenants: (1) net income after taxes not less than \$1.00 (one dollar) on an annual basis, determined as of each fiscal year end, and (2) pre-tax profit of not less than \$1.00 (one dollar) on a quarterly basis, determined as of each fiscal end.

Management expects that current liquid assets, the funds anticipated to be generated from operations and credit available under the Credit Agreement will be sufficient in the aggregate to fund the Company's working capital needs for the foreseeable future.

The continuing dislocation in the credit markets has exacerbated a decline in the current market value of a certain portion of the Company's investment portfolio allocated to four closed-end bond funds to an amount below the original investment of \$4.0 million. These closed-end bond funds were valued at \$1.1 million as a component of current marketable securities at June 30, 2008. Management currently views the decrement in value to be temporary in nature due to market conditions, coupled with the continuing financial performance of the underlying securities and the Company's ability to continue to hold the bond funds. If the decline in value is determined in the future to be other than temporary, the Company could be required to record a material impairment charge.

Inflation

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

Forward-Looking Information

Statements in this report which are not historical in nature, including discussion of economic conditions and favorable trends in the Company's market areas and effect on revenue growth, the potential for and effect of past and future acquisitions, the effect of changes in the Company's mix of services on gross margin, the adequacy of the Company's workers' compensation reserves and allowance for doubtful accounts, the effect of the Company's formation of a wholly owned, fully licensed captive insurance subsidiary and becoming self-insured for certain business risks, the effectiveness of the Company's management information systems, payment of future dividends, the recoverability of the carrying value of certain investments, and the availability of financing and working capital to meet the Company's funding requirements, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company or industry to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors with respect to the Company include difficulties associated with integrating acquired

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BARRETT BUSINESS SERVICES, INC.

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

Forward-Looking Information (Continued)

businesses and clients into the Company's operations, economic trends in the Company's service areas, material deviations from expected future workers' compensation claims experience, the effect of changes in the workers' compensation regulatory environment in one or more of the Company's primary markets, collectibility of accounts receivable, conditions in the global capital markets that may influence whether the market value of a portion of the Company's investment portfolio, which is currently below cost, is other than temporary, the carrying values of deferred income tax assets and goodwill, which may be affected by the Company's future operating results, the availability of capital or letters of credit necessary to meet state-mandated surety deposit requirements for maintaining the Company's status as a qualified self-insured employer for workers' compensation coverage, and the use of \$54.5 million in cash and marketable securities, among others. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk for changes in interest rates primarily relates to its investment portfolio of liquid assets. As of June 30, 2008, the Company's investment portfolio consisted principally of approximately \$39.3 million in tax-exempt municipal bonds with an average maturity of 157 days, \$14.1 million in a tax-exempt money market fund and approximately \$1.8 million in bond funds and corporate bonds. Based on the Company's overall interest exposure at June 30, 2008, a 100 basis point increase in market interest rates would not have a material effect on the fair value of the Company's investment portfolio of liquid assets or its results of operations because of the predominantly short maturities of the securities within the investment portfolio.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company conducted an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of June 30, 2008, continued to be ineffective in providing a reasonable level of assurance that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, as a result of the material weakness identified as of December 31, 2006 and continued to exist as of December 31, 2007, the nature of which is summarized below.

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BARRETT BUSINESS SERVICES, INC.

Item 4. Controls and Procedures (Continued)
Internal Control Over Financial Reporting

In our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2007, a material weakness existed and is summarized as follows:

The Company's information technology (IT) general controls over program development, program changes, computer operations, and access to programs and data were ineffectively designed as of December 31, 2007. Formal written policies and procedures and consistent practices, as well as formal documentation demonstrating the performance of key controls, did not exist for most areas within the aforementioned IT general controls. In addition, numerous and pervasive deficiencies were identified related to the absence of restricted access and segregation of duties, testing and authorization of system changes, and logging of system processing interruptions. These deficiencies, and their associated reflection on the control environment, when aggregated with other deficiencies affecting the control environment, resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim financial statements would not be prevented or detected.

In order to address the material weakness in our IT systems described above, management initiated the following remedial actions during 2007 and will continue with these priorities throughout 2008:

1. Implementation of policies and procedures to ensure consistent practices for managing access and changes to the financial systems;
2. Restricting access to the financial system transactions and data; and
3. Implementation of standards for logging, testing, and authorizing changes with potential to impact the financial systems.

During 2007, the Company hired an additional IT professional to provide more IT management resources to address the foregoing issues, including segregation of duties issues. Management will continue to seek a balance in priorities among its available resources while it proceeds with the foregoing remediation plan and the ongoing needs of the business.

Management believes that these measures, when fully implemented, will mitigate the material weakness described above. The Audit Committee of the Board of Directors and management will continue to monitor the implementation of these remedial measures and the effectiveness of our internal controls and procedures on an ongoing basis. As noted below, due to the ongoing nature of the implementation of these remedial measures, the changes in our internal control over financial reporting completed during the quarter ended June 30, 2008, did not have a material effect on such internal control.

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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BARRETT BUSINESS SERVICES, INC.

Part II Other Information

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in our 2007 Annual Report on Form 10-K.

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

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

| Month | Shares Repurchased | Average Price Per Share | Total Value of Shares Repurchased as Part of Publicly Announced Plan | Maximum Number of Shares that May Yet Be Repurchased Under the Plan |
|-------|--------------------|-------------------------|--|---|
| April | 59,300 | \$ 12.12 | \$ 719,000 | 684,107 |
| May | 126,500 | 12.29 | 1,555,000 | 557,607 |
| June | 52,700 | 11.95 | 630,000 | 504,907 |
| Total | 238,500 | \$ 12.18 | \$ 2,904,000 | |

Item 4. Submission of Matters to Vote of Security Holders

The Company held its 2008 annual meeting of stockholders on May 14, 2008. The following directors were elected at the annual meeting:

| | For | Withheld |
|-----------------------|------------|----------|
| Thomas J. Carley | 9,642,668 | 826,671 |
| James B. Hicks, Ph.D. | 9,637,262 | 832,077 |
| Roger L. Johnson | 10,304,901 | 164,438 |
| Jon L. Justesen | 10,333,205 | 136,134 |
| Anthony Meeker | 10,306,965 | 162,374 |
| William W. Sherertz | 10,305,600 | 163,739 |

Item 6. Exhibits

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BARRETT BUSINESS SERVICES, INC.
(Registrant)

Date: August 11, 2008

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

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EXHIBIT INDEX

Exhibit

| | |
|------|--|
| 10.1 | Amendment to Credit Agreement entered into as of July 1, 2008, between the Company and Wells Fargo Bank, N.A. (Wells Fargo). |
| 10.2 | Revolving Line of Credit Note dated July 1, 2008, in the amount of \$7,000,000 issued by the Company in favor of Wells Fargo. |
| 31.1 | Certification of the Chief Executive Officer under Rule 13a-14(a). |
| 31.2 | Certification of the Chief Financial Officer under Rule 13a-14(a). |
| 32 | Certification pursuant to 18 U.S.C. Section 1350. |