

**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 30, 2012**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Number of shares of common stock, \$.01 par value, outstanding at July 31, 2012 was 7,003,931 shares.

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.

INDEX

	<u>Page</u>
<a href="#">Part I—Financial Information</a>	
<a href="#">Item 1. Unaudited Interim Consolidated Financial Statements</a>	
<a href="#">Consolidated Balance Sheets – June 30, 2012 and December 31, 2011</a>	3
<a href="#">Consolidated Statements of Operations—Three Months Ended June 30, 2012 and 2011</a>	4
<a href="#">Consolidated Statements of Operations—Six Months Ended June 30, 2012 and 2011</a>	5
<a href="#">Consolidated Statements of Comprehensive Income—Three Months Ended June 30, 2012 and 2011</a>	6
<a href="#">Consolidated Statements of Comprehensive Income—Six Months Ended June 30, 2012 and 2011</a>	6
<a href="#">Consolidated Statements of Stockholders’ Equity—Six Months Ended June 30, 2012 and 2011</a>	7
<a href="#">Consolidated Statements of Cash Flows—Six Months Ended June 30, 2012 and 2011</a>	8
<a href="#">Notes to Unaudited Interim Consolidated Financial Statements</a>	9
<a href="#">Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	15
<a href="#">Item 3. Quantitative and Qualitative Disclosures About Market Risk</a>	24
<a href="#">Item 4. Controls and Procedures</a>	25
<a href="#">Part II—Other Information</a>	
<a href="#">Item 1A. Risk Factors</a>	26
<a href="#">Item 6. Exhibits</a>	26
<a href="#">Signatures</a>	27
<a href="#">Exhibit Index</a>	28

[Table of Contents](#)

## Part I—Financial Information

## Item 1. Financial Statements

BARRETT BUSINESS SERVICES, INC.  
Consolidated Balance Sheets  
(Unaudited)  
(In thousands, except per share amounts)

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 36,358	\$ 49,571
Marketable securities	14,240	16,878
Trade accounts receivable, net	63,433	46,520
Income taxes receivable	3,432	4,133
Prepaid expenses and other	2,914	5,897
Deferred income taxes	5,931	5,958
Total current assets	<u>126,308</u>	<u>128,957</u>
Marketable securities	17,439	15,395
Property, equipment and software, net	15,832	15,007
Restricted marketable securities and workers' compensation deposits	9,932	9,923
Other assets	3,035	3,027
Workers' compensation receivables for insured losses and recoveries	1,601	2,968
Goodwill	47,820	47,820
	<u>\$221,967</u>	<u>\$ 223,097</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,913	\$ 1,639
Accrued payroll, payroll taxes and related benefits	68,385	52,340
Income taxes payable	193	0
Other accrued liabilities	350	300
Workers' compensation claims liabilities	19,670	18,718
Safety incentives liability	7,541	6,321
Total current liabilities	<u>98,052</u>	<u>79,318</u>
Long-term workers' compensation claims liabilities	35,231	30,596
Long-term workers' compensation claims liabilities for insured claims	864	1,879
Deferred income taxes	8,152	8,152
Mandatorily redeemable preferred stock, \$.01 par value; 50 shares authorized; 35 and 0 shares issued and outstanding	34,800	0
Customer deposits and other long-term liabilities	1,502	1,497
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value; 450 shares authorized; no shares issued and outstanding	0	0
Common stock, \$.01 par value; 20,500 shares authorized, 7,003 and 9,871 shares issued and outstanding	70	99
Additional paid-in capital	316	20,943
Accumulated other comprehensive income (loss)	9	(34)
Retained earnings	42,971	80,647
	<u>43,366</u>	<u>101,655</u>
	<u>\$221,967</u>	<u>\$ 223,097</u>

The accompanying notes are an integral part of these financial statements

[Table of Contents](#)

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

	Three Months Ended June 30,	
	2012	2011
Revenues:		
Staffing services	\$30,387	\$30,518
Professional employer service fees	65,113	45,495
Total revenues	95,500	76,013
Cost of revenues:		
Direct payroll costs	22,843	23,093
Payroll taxes and benefits	39,332	28,886
Workers' compensation	16,984	10,753
Total cost of revenues	79,159	62,732
Gross margin	16,341	13,281
Selling, general and administrative expenses	10,549	8,871
Depreciation and amortization	357	331
Income from operations	5,435	4,079
Other income:		
Investment income, net	205	273
Other	(9)	(7)
Other income	196	266
Income before income taxes	5,631	4,345
Provision for income taxes	1,888	896
Net income	\$ 3,743	\$ 3,449
Basic earnings per common share	\$ .54	\$ .34
Weighted average number of basic common shares outstanding	6,995	10,196
Diluted earnings per common share	\$ .53	\$ .34
Weighted average number of diluted common shares outstanding	7,078	10,245
Dividends declared per common share	\$ .11	\$ .09

The accompanying notes are an integral part of these financial statements

[Table of Contents](#)

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

	Six Months Ended June 30,	
	2012	2011
<b>Revenues:</b>		
Staffing services	\$ 56,598	\$ 58,850
Professional employer service fees	121,324	85,932
Total revenues	<u>177,922</u>	<u>144,782</u>
<b>Cost of revenues:</b>		
Direct payroll costs	42,495	44,541
Payroll taxes and benefits	82,324	60,649
Workers' compensation	30,205	20,713
Total cost of revenues	<u>155,024</u>	<u>125,903</u>
Gross margin	22,898	18,879
Selling, general and administrative expenses	20,313	17,698
Depreciation and amortization	704	666
Income from operations	<u>1,881</u>	<u>515</u>
<b>Other income:</b>		
Life insurance proceeds	0	10,000
Investment income, net	428	628
Other	(16)	92
Other income	<u>412</u>	<u>10,720</u>
Income before income taxes	2,293	11,235
Provision for income taxes	763	2,240
Net income	<u>\$ 1,530</u>	<u>\$ 8,995</u>
Basic earnings per common share	<u>\$ .18</u>	<u>\$ .88</u>
Weighted average number of basic common shares outstanding	<u>8,435</u>	<u>10,198</u>
Diluted earnings per common share	<u>\$ .18</u>	<u>\$ .88</u>
Weighted average number of diluted common shares outstanding	<u>8,511</u>	<u>10,246</u>
Dividends declared per common share	<u>\$ .22</u>	<u>\$ .18</u>

The accompanying notes are an integral part of these financial statements

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.  
Consolidated Statements of Comprehensive Income  
(Unaudited)  
(In thousands)

	Three Months Ended June 30,	
	2012	2011
Net income	\$3,743	\$3,449
Unrealized gains on marketable securities, net of tax of \$1 and \$6 in 2012 and 2011, respectively	2	10
Comprehensive income	<u>\$3,745</u>	<u>\$3,459</u>

  

	Six Months Ended June 30,	
	2012	2011
Net income	\$1,530	\$8,995
Unrealized gains on marketable securities, net of tax of \$27 and \$22 in 2012 and 2011, respectively	43	35
Comprehensive income	<u>\$1,573</u>	<u>\$9,030</u>

The accompanying notes are an integral part of these financial statements

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.  
Consolidated Statements of Stockholders' Equity  
Six Months Ended June 30, 2012 and 2011  
(In thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total
	Shares	Amount				
Balance, December 31, 2010	10,202	\$ 102	\$ 25,164	\$ (65)	\$ 70,164	\$ 95,365
Common stock issued on exercise of options	3	0	5	0	0	5
Stock option compensation expense, net of tax	0	0	192	0	0	192
Tax benefit of stock option exercises	0	0	13	0	0	13
Repurchase of common stock	(65)	(1)	(922)	0	0	(923)
Cash dividend on common stock	0	0	0	0	(1,837)	(1,837)
Unrealized holding gains on marketable securities, net of tax	0	0	0	35	0	35
Net income	0	0	0	0	8,995	8,995
Balance, June 30, 2011	<u>10,140</u>	<u>101</u>	<u>24,452</u>	<u>(30)</u>	<u>77,322</u>	<u>101,845</u>
Balance, December 31, 2011	9,871	99	20,943	(34)	80,647	101,655
Common stock issued on exercise of options	118	1	1,688	0	0	1,689
Stock option compensation expense, net of tax	0	0	285	0	0	285
Tax benefit of stock option exercises	0	0	264	0	0	264
Repurchase of common stock	(2,986)	(30)	(22,864)	0	(37,338)	(60,232)
Cash dividend on common stock	0	0	0	0	(1,868)	(1,868)
Unrealized holding gains on marketable securities, net of tax	0	0	0	43	0	43
Net income	0	0	0	0	1,530	1,530
Balance, June 30, 2012	<u>7,003</u>	<u>70</u>	<u>\$ 316</u>	<u>\$ 9</u>	<u>\$ 42,971</u>	<u>\$ 43,366</u>

The accompanying notes are an integral part of these financial statements

[Table of Contents](#)

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

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 1,530	\$ 8,995
Reconciliations of net income to net cash provided by operating activities:		
Depreciation and amortization	704	666
Gains recognized on marketable securities	0	(100)
Gain recognized on sale and leaseback	(61)	(61)
Deferred income taxes	53	292
Share based compensation	285	192
Changes in certain assets and liabilities:		
Trade accounts receivable, net	(16,913)	(22,142)
Income taxes receivable	701	0
Prepaid expenses and other	2,983	(628)
Accounts payable	274	(270)
Accrued payroll, payroll taxes and related benefits	16,045	22,830
Other accrued liabilities	50	364
Income taxes payable	193	498
Workers' compensation claims liabilities	5,939	1,810
Safety incentives liability	1,220	33
Customer deposits, long-term liabilities and other assets, net	56	23
Net cash provided by operating activities	<u>13,059</u>	<u>12,502</u>
Cash flows from investing activities:		
Purchase of property and equipment	(1,527)	(445)
Proceeds from sales and maturities of marketable securities	22,924	18,562
Purchase of marketable securities	(22,313)	(32,710)
Proceeds from maturities of restricted marketable securities	4,671	3,360
Purchase of restricted marketable securities	(4,680)	(3,979)
Net cash used in investing activities	<u>(925)</u>	<u>(15,212)</u>
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,689	5
Dividends paid	(1,868)	(1,837)
Repurchase of common stock	(25,432)	(923)
Tax benefit of stock option exercises	264	13
Net cash used in financing activities	<u>(25,347)</u>	<u>(2,742)</u>
Net decrease in cash and cash equivalents	(13,213)	(5,452)
Cash and cash equivalents, beginning of period	49,571	30,924
Cash and cash equivalents, end of period	<u>\$ 36,358</u>	<u>\$ 25,472</u>
Supplemental schedule of noncash financing activities:		
Issuance of mandatorily redeemable preferred stock	\$ 34,800	\$ 0
	<u>\$ 34,800</u>	<u>\$ 0</u>

The accompanying notes are an integral part of these financial statements



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”, the “Company”, “our” or “we”), 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 2011 Annual Report on Form 10-K at pages F1 – F28. The results of operations for an interim period are not necessarily indicative of the results of operations for a full year.

**Revenue recognition**

We recognize revenue as services are rendered by our workforce. Staffing services are engaged by customers to meet short-term and long-term personnel needs. Professional employer organization (“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, which cover all employees at a particular work site. Our PEO contracts are renewable on an annual basis and typically require 30 days’ written notice to cancel or terminate the contract by either party. Our PEO contracts provide for immediate termination upon any default of the client regardless of when notice is given. We report PEO 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. Consequently, our PEO service fee revenues represent the gross margin generated from our PEO services after deducting the amounts invoiced to PEO customers for direct payroll expenses such as salaries, wages, health insurance and employee out-of-pocket expenses incurred incidental to employment and safety incentives. These amounts are also excluded from cost of revenues. PEO service fees also include amounts invoiced to our clients for employer payroll-related taxes and workers’ compensation coverage.

**Marketable securities**

As of June 30, 2012, the Company’s marketable securities consisted of tax-exempt municipal securities, corporate bonds and U.S. treasuries. The Company classifies municipal securities, U.S. treasuries, and certain of its corporate bonds as available for sale; they are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of accumulated other comprehensive income (loss) in stockholders’ equity. In the event a loss is determined to be other-than-temporary, the loss will be recognized in the statement of operations. Certain of the Company’s corporate bonds are classified as held-to-maturity and are reported at amortized cost.

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

**Allowance for doubtful accounts**

The Company had an allowance for doubtful accounts of \$366,000 and \$452,000 at June 30, 2012 and December 31, 2011, respectively. The Company must make estimates of the collectibility of accounts receivable. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic conditions and changes in customers' payment trends when evaluating the adequacy of the allowance for doubtful accounts. The Company deems an account balance uncollectible only after it has pursued all available assets of the customer and, where applicable, the assets of the personal guarantor.

**Workers' compensation claims**

The Company is a self-insured employer with respect to workers' compensation coverage for all of its employees (including employees subject to PEO contracts) working in California, Oregon, Maryland, Delaware and Colorado. In the state of Washington, state law allows only the Company's staffing services and internal management employees to be covered under the Company's self-insured workers' compensation program. Additionally, the Company operates a wholly-owned fully licensed insurance company, Ecole Insurance Company ("Ecole"), in Arizona to provide workers' compensation coverage to our employees in Arizona.

To manage our financial exposure, in the event of catastrophic injuries or fatalities, the Company maintains excess workers' compensation insurance through our wholly owned captive insurance company, Associated Insurance Company for Excess ("AICE"), with a per occurrence retention of \$5.0 million, except in Maryland and Colorado, where our per occurrence retention is \$1.0 million and \$500,000, respectively. AICE maintains excess workers' compensation insurance coverage with Chartis, formerly known as American Insurance Group, Inc., between \$5.0 million and \$15.0 million per occurrence, except in Maryland, where coverage with Chartis is between \$1.0 million and \$25.0 million per occurrence, and in Colorado, where the coverage with Chartis is between \$500,000 and statutory limits per occurrence. The Company continues to evaluate the financial capacity of our insurers to assess the recoverability of the related insurer receivables.

The Company has provided a total of \$55.8 million and \$51.2 million at June 30, 2012 and December 31, 2011, 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. These insured claims totaled \$864,000 at June 30, 2012 and \$1.9 million at December 31, 2011. The estimated liability for unsettled workers' compensation claims represents management's best estimate based upon an actuarial valuation provided by a third party actuary. Included in the claims liabilities are case reserve estimates for reported losses, plus additional amounts based on projections for incurred but not reported claims and anticipated increases in case reserve estimates. Also included in these estimates are amounts for unallocated loss adjustment expenses, including legal costs. These estimates are continually reviewed and adjustments to liabilities are reflected in current operating results as they become known.

BARRETT BUSINESS SERVICES, INC.  
Notes to Consolidated Financial Statements (Unaudited) *(Continued)*

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

**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 agreed-upon loss objectives. The Company has provided \$7.5 million at June 30, 2012 and \$6.3 million at December 31, 2011 as an estimate of the liability for unpaid safety incentives. The incentive is based on a percentage of annual payroll and is paid annually to customers who meet predetermined workers' compensation claims cost objectives. Safety incentive payments 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, and the expected payout as determined by historical incentive payment trends. Safety incentive expense is netted against PEO services revenue in our consolidated statements of operations.

**Note 2 – Stock Repurchase**

Effective March 28, 2012, the Company repurchased 2,485,929 shares of the Company's common stock held by the Estate of William W. Sherertz and 500,000 common shares held by Nancy Sherertz. Mr. Sherertz, a founder and former president and CEO of the Company, died January 20, 2011. Nancy Sherertz is also a founder of the Company. The common shares were repurchased at a price of \$20 per share, representing total consideration of \$59.7 million. The Company used a combination of \$24.9 million in cash and issued 34,800 shares of Series A Nonconvertible, Non-Voting Redeemable Preferred Stock with a liquidation preference of \$1,000 per share. Additionally, the Company incurred professional and legal fees totaling \$514,000 related to the transaction. The preferred stock is entitled to receive cumulative preferential dividends at the rate of 5% per annum based upon the \$1,000 liquidation preference with such rate increasing by 2% on each April 1 beginning April 1, 2013, until all of the outstanding preferred stock has been redeemed. The Company may pay the dividends in cash or in additional shares of preferred stock at its option. The Company may redeem all or a portion of the preferred stock at its option at any time at a price of \$1,000 per share. The preferred stock is subject to mandatory redemption five years from the original issue date. Due to the mandatory redemption provision the preferred stock is classified as a liability on the Company's consolidated balance sheet.

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.  
Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 3—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 common share reflect the potential effects of the exercise of outstanding stock options. Basic and diluted common shares outstanding are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Weighted average number of basic common shares outstanding	6,995,066	10,195,989	8,434,962	10,198,440
Assumed exercise of stock options, net of shares assumed repurchased at average market price during the period using proceeds received upon exercise of options	83,010	48,725	76,313	47,805
Weighted average number of diluted common shares outstanding	<u>7,078,076</u>	<u>10,244,714</u>	<u>8,511,275</u>	<u>10,246,245</u>

**Note 4 – Stock Incentive Plans and Stock-Based Compensation**

The following table summarizes stock option activity in 2012 under the Company's 2009 Stock Incentive Plan:

	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2011	671,294	\$ 14.48
Options granted	7,500	\$ 17.55
Options exercised	(118,472)	\$ 14.26
Options cancelled or expired	0	
Outstanding at June 30, 2012	<u>560,322</u>	\$ 14.57
Exercisable at June 30, 2012	<u>252,797</u>	\$ 13.49
Available for grant at June 30, 2012	<u>626,300</u>	

During 2012, the Company granted 7,500 options at a fair value of \$9.08 per share as determined under the Black-Scholes option-pricing model.

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.  
Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 4 – Stock Incentive Plans and Stock-Based Compensation (Continued)**

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

(\$ in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Intrinsic value of options exercised in the period	\$ 91	\$ 0	\$ 680	\$ 34

  

	As of June 30,	
	2012	2011
Stock options:		
Aggregate intrinsic value	\$ 1,934	\$ 415
Weighted average contractual term of options	7.07 years	7.41 years

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

**Note 5—Workers' Compensation**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Beginning balance				
Workers' compensation claims liabilities	\$52,794	\$39,783	\$51,193	\$39,301
Add: claims expense accrual:				
Current period	8,170	5,279	16,333	9,985
Prior periods	3,110	286	3,110	522
Total expense accrual	11,280	5,565	19,443	10,507
Less: claim payments related to:				
Current period	1,304	962	1,583	1,219
Prior periods	7,005	3,390	13,288	7,593
Total paid	8,309	4,352	14,871	8,812
Ending balance				
Workers' compensation claims liabilities	\$55,765	\$40,996	\$55,765	\$40,996
Incurred but not reported (IBNR)	\$41,000	\$29,738	\$41,000	\$29,738

[Table of Contents](#)

BARRETT BUSINESS SERVICES, INC.  
Notes to Consolidated Financial Statements (Unaudited) (Continued)

**Note 5—Workers' Compensation (Continued)**

During the three months ended June 30, 2012, the Company recorded \$3.1 million of additional workers' compensation expense related to increases in estimated costs to close prior year claims.

**Note 6—Fair Value Measurement**

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

	June 30, 2012			December 31, 2011			Fair Value Category
	Cost	Gross Unrealized Gains	Recorded Basis	Cost	Gross Unrealized Gains (Losses)	Recorded Basis	
<b>Current:</b>							
<b>Available-for-sale:</b>							
Municipal bonds	\$ 3,374	\$ 4	\$ 3,378	\$ 5,804	\$ 8	\$ 5,812	2
Corporate bonds	10,853	9	10,862	11,070	(4)	11,066	2
	<u>\$14,227</u>	<u>\$ 13</u>	<u>\$14,240</u>	<u>\$16,874</u>	<u>\$ 4</u>	<u>\$16,878</u>	
<b>Long term:</b>							
<b>Available-for-sale:</b>							
Municipal bonds	\$ 299	\$ 0	\$ 299	\$ 0	\$ 0	\$ 0	2
Corporate bonds	15,100	18	15,118	14,971	(33)	14,938	2
U.S. treasuries	1,558	2	1,560	0	0	0	1
<b>Held-to-maturity:</b>							
Corporate bonds	462	0	462	457	0	457	2
	<u>\$17,419</u>	<u>\$ 20</u>	<u>\$17,439</u>	<u>\$15,428</u>	<u>\$ (33)</u>	<u>\$15,395</u>	

The Company's restricted marketable securities component of restricted marketable securities and workers' compensation deposits consists of the following (in thousands):

	June 30, 2012			December 31, 2011			Fair Value Category
	Cost	Gross Unrealized Gains (Losses)	Recorded Basis	Cost	Gross Unrealized Gains (Losses)	Recorded Basis	
<b>Available-for-sale:</b>							
Municipal bonds	\$5,190	\$ 20	\$ 5,210	\$5,580	\$ 17	\$ 5,597	2
Corporate bonds	927	(1)	926	148	(1)	147	2
U.S. treasuries	1,567	0	1,567	1,567	0	1,567	1
	<u>\$7,684</u>	<u>\$ 19</u>	<u>\$ 7,703</u>	<u>\$7,295</u>	<u>\$ 16</u>	<u>\$ 7,311</u>	

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## Table of Contents

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

#### Overview

Barrett Business Services, Inc. ("Barrett", the "Company," "our" 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 businesses.

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

- allowing clients to focus on core business activities instead of human resource matters;
- increasing clients' productivity by improving employee satisfaction and generating greater employee retention;
- reducing overall payroll expenses due to lower workers' compensation and health insurance costs; and
- assisting clients in complying with complex and evolving human resource-related regulatory and tax issues.

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

## [Table of Contents](#)

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

#### Results of Operations

The following table sets forth 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, 2012 and 2011.

	Percentage of Total Revenues Three Months Ended June 30,		Percentage of Total Revenues Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Staffing services	31.8%	40.1%	31.8%	40.6%
Professional employer service fees	68.2	59.9	68.2	59.4
Total revenues	100.0	100.0	100.0	100.0
<b>Cost of revenues:</b>				
Direct payroll costs	23.9	30.4	23.9	30.8
Payroll taxes and benefits	41.2	38.0	46.2	41.9
Workers' compensation	17.8	14.1	17.0	14.3
Total cost of revenues	82.9	82.5	87.1	87.0
Gross margin	17.1	17.5	12.9	13.0
Selling, general and administrative expenses	11.0	11.7	11.4	12.2
Depreciation and amortization	0.4	0.4	0.4	0.4
Income from operations	5.7	5.4	1.1	0.4
Other income	0.2	0.3	0.2	7.4
Income before income taxes	5.9	5.7	1.3	7.8
Provision for income taxes	2.0	1.2	0.4	1.6
Net income	3.9%	4.5%	0.9%	6.2%

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



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

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

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.

(in thousands)	Unaudited Three Months Ended June 30,		Unaudited Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Staffing services	\$ 30,387	\$ 30,518	\$ 56,598	\$ 58,850
Professional employer services	<u>463,671</u>	<u>336,380</u>	<u>869,521</u>	<u>639,114</u>
Total revenues	<u>494,058</u>	<u>366,898</u>	<u>926,119</u>	<u>697,964</u>
<b>Cost of revenues:</b>				
Direct payroll costs	418,594	312,385	785,527	595,027
Payroll taxes and benefits	39,332	28,886	82,324	60,649
Workers' compensation	<u>19,791</u>	<u>12,346</u>	<u>35,370</u>	<u>23,409</u>
Total cost of revenues	<u>477,717</u>	<u>353,617</u>	<u>903,221</u>	<u>679,085</u>
Gross margin	<u>\$ 16,341</u>	<u>\$ 13,281</u>	<u>\$ 22,898</u>	<u>\$ 18,879</u>

[Table of Contents](#)

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

Results of Operations (Continued)

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

(in thousands)	Unaudited Three Months Ended June 30,					
	Gross Revenue Reporting Method		Reclassification		Net Revenue Reporting Method	
	2012	2011	2012	2011	2012	2011
<b>Revenues:</b>						
Staffing services	\$ 30,387	\$ 30,518	\$ 0	\$ 0	\$ 30,387	\$ 30,518
Professional employer services	463,671	336,380	(398,558)	(290,885)	65,113	45,495
Total revenues	\$494,058	\$366,898	\$(398,558)	\$(290,885)	\$95,500	\$76,013
<b>Cost of revenues</b>	<u>\$477,717</u>	<u>\$353,617</u>	<u>\$(398,558)</u>	<u>\$(290,885)</u>	<u>\$79,159</u>	<u>\$62,732</u>

(in thousands)	Unaudited Six Months Ended June 30,					
	Gross Revenue Reporting Method		Reclassification		Net Revenue Reporting Method	
	2012	2011	2012	2011	2012	2011
<b>Revenues:</b>						
Staffing services	\$ 56,598	\$ 58,850	\$ 0	\$ 0	\$ 56,598	\$ 58,850
Professional employer services	869,521	639,114	(748,197)	(553,182)	121,324	85,932
Total revenues	\$926,119	\$697,964	\$(748,197)	\$(553,182)	\$177,922	\$144,782
<b>Cost of revenues</b>	<u>\$903,221</u>	<u>\$679,085</u>	<u>\$(748,197)</u>	<u>\$(553,182)</u>	<u>\$155,024</u>	<u>\$125,903</u>

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

**Three months ended June 30, 2012 and 2011**

Net income for the second quarter of 2012 amounted to \$3.7 million, as compared to net income of \$3.4 million for the second quarter of 2011. The increase in net income for the 2012 second quarter was primarily due to a 25.6% increase in revenues. The second quarter of 2011 included the benefit of a lower annual effective income tax rate as a result of the effect of the receipt of \$10.0 million of key man life insurance proceeds. Diluted income per share for the second quarter of 2012 was \$.53 compared to diluted income per share of \$.34 for the comparable 2011 period.

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[Table of Contents](#)

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

Results of Operations (Continued)

*Three months ended June 30, 2012 and 2011 (Continued)*

Revenues for the second quarter of 2012 totaled \$95.5 million, an increase of approximately \$19.5 million or 25.6%, which reflects an increase in the Company's PEO service fee revenue of \$19.6 million or 43.1% and a small decline in staffing services revenue of \$130,000 or 0.4%.

Our growth in PEO revenues continues to be primarily attributable to new customers as PEO business from new customers during the second quarter of 2012 more than tripled our lost PEO business from former customers. PEO revenues from continuing customers reflected a 7.1% increase compared to the second quarter of 2011 primarily resulting from increases in employee headcount and hours worked. Staffing revenues remained at a similar level as lost business from former customers was nearly offset by business from new and continuing customers.

Gross margin for the second quarter of 2012 totaled approximately \$16.3 million or an increase of 23.0% over the second quarter of 2011, primarily due to the 25.6% increase in revenues and a decline in direct payroll costs, partially offset by higher payroll taxes and benefits and workers' compensation expense, as a percentage of revenues.

The decrease in direct payroll costs, as a percentage of revenues, from 30.4% for the second quarter of 2011 to 23.9% for the second quarter of 2012 was primarily due to the increase in our mix of PEO services in the Company's customer base over the second quarter of 2011 and the effect of each customer's unique mark-up percent.

Payroll taxes and benefits, as a percentage of revenues, for the second quarter of 2012 was 41.2% compared to 38.0% for the second quarter of 2011. The percentage rate increase was largely due to the effect of significant growth in PEO services, where payroll taxes and benefits are presented at gross cost whereas the related direct payroll costs are netted against PEO services revenue, and to slightly higher effective state unemployment tax rates in various states in which the Company operates as compared to the second quarter of 2011. Management expects the trend in payroll taxes and benefits, as a percentage of revenues, to continue to increase as a result of continued growth in PEO services on a quarter over quarter basis.

Workers' compensation expense, in terms of dollars and as a percentage of revenues, increased from \$10.8 million or 14.1% in the second quarter of 2011 to \$17.0 million or 17.8% in the second quarter of 2012. The percentage rate increase was primarily due to an increase in the provision for claim costs related to current year claims and increases in estimated costs to close prior year claims and higher insurance broker commissions as a result of increased worker's compensation insurance rates.

Selling, general and administrative ("SG&A") expenses for the second quarter of 2012 totaled approximately \$10.5 million, an increase of \$1.7 million or 18.9% over the second quarter of 2011. The increase was primarily attributable to increases in management payroll and profit sharing based on increased branch performance as well as the variable expense components within SG&A to support the business growth.

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[Table of Contents](#)

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

Results of Operations (Continued)

*Three months ended June 30, 2012 and 2011 (Continued)*

Other income for the second quarter of 2012 was \$196,000 compared to other income of \$266,000 for the second quarter of 2011. Other income for the 2012 second quarter was primarily attributable to investment income earned on the Company's cash and marketable securities.

The income tax rate for the 2012 second quarter was 33.5%. We expect the effective income tax rate for the balance of 2012 to remain at a similar rate to the 2012 second quarter income tax rate. The income tax rate for the 2011 second quarter was 20.6% which included a favorable benefit from the effect of a much lower annual effective tax rate attributable to the non-taxable \$10.0 million life insurance proceeds.

*Six months ended June 30, 2012 and 2011*

Net income for the six months ended June 30, 2012 amounted to \$1.5 million, as compared to net income of \$9.0 million for the first six months of 2011. The first six months of 2011 included \$10.0 million of key man life insurance proceeds received following the passing of the Company's former president and CEO and the related benefit of a lower annual effective income tax rate. Diluted income per share for the first six months ended June 30, 2012 was \$.18 compared to diluted income per share of \$.88 for the comparable 2011 period.

Revenues for the six months ended June 30, 2012 totaled \$177.9 million, an increase of approximately \$33.1 million or 22.9%, compared to the similar period in 2011 which reflects an increase in the Company's PEO service fee revenue of \$35.4 million or 41.2% and a small decline in staffing services revenue of \$2.3 million or 3.8%. Our growth in PEO revenues was primarily attributable to the addition of new customers as PEO business from new customers during the first six months of 2012 more than tripled our lost PEO business from former customers. PEO revenues from continuing customers reflected a 8.4% increase compared to the first six months of 2011 primarily resulting from an increase in employee headcount and a slight increase in hours worked. Staffing revenues decreased because lost business from former customers exceeded the business from new and continuing customers.

Gross margin for the six months ended June 30, 2012 totaled approximately \$22.9 million or an increase of \$4.0 million over the comparable period of 2011, primarily due to the 22.9% increase in revenues and a decline in direct payroll costs, partially offset by higher payroll taxes and benefits and workers' compensation expense, as a percentage of revenues.

The decrease in direct payroll costs, as a percentage of revenues, from 30.8% for the second quarter of 2011 to 23.9% for the first six months of 2012 was primarily due to the increase in our mix of PEO services in the Company's customer base compared to the first six months of 2011 and the effect of each customer's unique mark-up percent.

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[Table of Contents](#)

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

Results of Operations (Continued)

*Six months ended June 30, 2012 and 2011 (Continued)*

Payroll taxes and benefits, as a percentage of revenues, for the first six months ended June 30, 2012 was 46.2% compared to 41.9% for the comparable period of 2011. The percentage rate increase was largely due to the effect of significant growth in PEO services and to higher effective state unemployment tax rates in various states in which the Company operates as compared to the same period of 2011.

Workers' compensation expense, in terms of dollars and as a percentage of revenues, increased from \$20.7 million or 14.3% in the first six months of 2011 to \$30.2 million or 17.0% in the first six months of 2012. The percentage rate increase was primarily due to an increase in the provision for current year claim costs as well as increases in estimated costs to close prior year claims and higher insurance broker commissions as a result of increased worker's compensation insurance rates.

SG&A expenses for the first six months of 2012 totaled approximately \$20.3 million, an increase of \$2.6 million or 14.7% over the first six months of 2011. The increase was primarily attributable to increases in management payroll and profit sharing based on increased branch performance and to higher legal expenses.

Other income for the first six months of 2012 was \$412,000 compared to other income of \$10.7 million for the first six months of 2011. Other income for the first six months of 2012 was primarily attributable to investment income earned on the Company's cash and marketable securities. The first six months of 2011 included the \$10.0 million of key man life insurance proceeds.

The income tax rate for the first six months of 2012 was 33.3%. The income tax rate for the first six months of 2011 was 19.9% which included a favorable benefit from the effect of a much lower annual effective tax rate attributable to the non-taxable \$10.0 million life insurance proceeds.

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

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## Table of Contents

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

#### Factors Affecting Quarterly Results (Continued)

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, 2012 decreased \$13.2 million from December 31, 2011, which compares to a decrease of \$5.5 million for the comparable period in 2011. The decrease in cash at June 30, 2012 as compared to December 31, 2011, was primarily due to \$25.4 million used to repurchase common stock, offset in part by the net income of \$1.5 million, a \$5.9 million increase in workers' compensation claims liabilities and a decrease in prepaid expenses and other of \$3.0 million.

Net cash provided by operating activities for the six months ended June 30, 2012 amounted to \$13.1 million compared to \$12.5 million for the comparable 2011 period. For the six months ended June 30, 2012, cash flow was principally provided by net income of \$1.5 million, coupled with a \$16.0 million increase in accrued payroll and payroll taxes, a \$5.9 million increase in workers' compensation claims liabilities, and a \$3.0 million decrease in prepaid expense and other, offset in part by a \$16.9 million increase in accounts receivable.

Net cash used in investing activities for the six months ended June 30, 2012 was \$925,000 as compared to \$15.2 million of net cash used in investing activities for the similar 2011 period. For the 2012 period, cash from investing activities was used in the purchase of marketable securities totaling \$22.3 million, the purchase of restricted marketable securities of \$4.7 million and the purchase of property and equipment of \$1.5 million, partially offset by the proceeds from the sales and maturities of marketable securities of \$22.9 million and \$4.7 million from the proceeds of restricted marketable securities. The transactions related to restricted marketable securities were scheduled maturities and the replacement of such securities held for workers' compensation surety deposit purposes. The Company presently has no material long-term capital commitments.

Net cash used in financing activities for the six months ended June 30, 2012 was \$25.3 million as compared to \$2.7 million for the similar 2011 period. For the 2012 period, the primary uses of cash for financing activities were the repurchases of the Company's common stock totaling \$25.4 million which included \$514,000 of professional and legal fees and the payment of regular quarterly cash dividends totaling \$1.9 million to holders of the Company's common stock, partially offset by \$1.7 million proceeds from the exercise of stock options.

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 businesses, 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.

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## Table of Contents

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

#### Liquidity and Capital Resources (Continued)

The Company is a party to a Standby Letter of Credit Agreement dated as of June 30, 2009 (the "Credit Agreement") with its principal bank. The Credit Agreement provides for standby letters of credit as to which there was \$6.7 million outstanding at June 30, 2012 in connection with various surety deposit requirements for workers' compensation purposes. Effective July 11, 2012, the outstanding standby letters of credit were increased by \$17.2 million related to an increase in the California self insured workers' compensation surety deposit requirement applicable to the Company in lieu of payment of assessment fees to the state of California.

Pursuant to the Credit Agreement, the Company is required to maintain compliance with the following covenants: (1) to maintain net income after taxes not less than \$1.00 (one dollar) on an annual basis, determined as of each fiscal year end; (2) to maintain liquid assets (defined as unencumbered cash, cash equivalents, and publicly traded and quoted marketable securities) having an aggregate fair market value at all times not less than \$10.0 million, determined as of the end of each fiscal quarter; and (3) to not borrow or permit to exist indebtedness (other than from or to the bank), or mortgage, pledge, grant, or permit to exist a security interest in, or a lien upon, all or any portion of the Company's assets now owned or hereafter acquired, except for purchase money indebtedness (and related security interests) which does not at any time exceed \$500,000. The Company was in compliance with all financial covenants at June 30, 2012.

As disclosed in Note 3 to the Consolidated Financial Statements in this report, effective March 28, 2012, the Company repurchased 2,485,929 shares of the Company's common stock held by the Estate of William W. Sherertz and 500,000 common shares held by Nancy Sherertz. Mr. Sherertz, a founder and former president and CEO of the Company, died January 20, 2011. Nancy Sherertz is also a founder of the Company. The common shares were repurchased at a price of \$20 per share, representing total consideration of \$59.7 million. The Company used a combination of \$24.9 million in cash and issued 34,800 shares of Series A Nonconvertible, Non-Voting Redeemable Preferred Stock with a liquidation preference of \$1,000 per share. Additionally, the Company incurred professional and legal fees totaling \$514,000 related to the transaction. The preferred stock is entitled to receive cumulative preferential dividends at the rate of 5% per annum based upon the \$1,000 liquidation preference with such rate increasing by 2% on each April 1 beginning April 1, 2013, until all of the outstanding preferred stock has been redeemed. The Company may pay the dividends in cash or in additional shares of preferred stock at its option. The Company may redeem all or a portion of the preferred stock at its option at any time at a price of \$1,000 per share. The preferred stock is subject to mandatory redemption five years from the original issue date. Due to the mandatory redemption provision the preferred stock is classified as a liability on the Company's consolidated balance sheet. Although no assurances can be given, the Company anticipates borrowing funds through a bank line of credit to redeem the preferred stock in full before September 28, 2012, in which event no dividend would be payable.

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

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[Table of Contents](#)

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

Inflation

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

Forward-Looking Information

Statements in this report which are not historical in nature, including discussion of economic conditions in the Company's market areas and effect on revenue levels, the potential for and effect of past and future acquisitions, the effect of changes in the Company's mix of services on gross margin, the adequacy of the Company's workers' compensation reserves and the effect of changes in estimate of its claims liabilities, the adequacy of the Company's allowance for doubtful accounts, the effect of the Company's formation and operation of two wholly owned, fully licensed captive insurance subsidiaries and becoming self-insured for certain business risks, the financial viability of the Company's excess insurance carriers, the effectiveness of the Company's management information systems, payment of future dividends, redemption of the Company's preferred stock, 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 the ability to retain current clients and attract new clients, the availability of financing or other sources of capital, including the impact of such availability on the Company's plans to redeem its preferred stock, difficulties associated with integrating acquired businesses and clients into the Company's operations, economic trends in the Company's service areas, material deviations from expected future workers' compensation claims experience, the effect of changes in the workers' compensation regulatory environment in one or more of the Company's primary markets, collectibility of accounts receivable, the carrying values of deferred income tax assets and goodwill, which may be affected by the Company's future operating results and 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, 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, 2012, the Company's investment portfolio consisted principally of approximately \$27.4 million in corporate bonds, \$12.0 million in tax-exempt money market funds, \$8.9 million in tax-exempt municipal bonds and \$3.1 million in U.S. treasuries. Based on the Company's overall interest exposure at June 30, 2012, a 100



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[Table of Contents](#)

**Item 3. Quantitative and Qualitative Disclosures About Market Risk (Continued)**

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**

Evaluation of Disclosure Controls and Procedures

As of June 30, 2012 the Company carried out 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 design and operation of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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## [Table of Contents](#)

### Part II – Other Information

#### **Item 1A. Risk Factors**

In addition to the risk factors disclosed in Item 1A of our 2011 Annual Report on Form 10-K, the following risk factor should be considered in connection with our issuance of 34,800 shares of Series A Nonconvertible, Non-Voting Redeemable Preferred Stock (the “Series A Preferred Stock”) on March 28, 2012.

#### **We may be unable to refinance the Series A Preferred Stock as planned.**

The Series A Preferred Stock issued on March 28, 2012, has a liquidation preference of \$1,000 per share, or a total of \$34,800,000. Holders of the Series A Preferred Stock are entitled to receive cumulative preferential dividends at the rate of 5% per annum based upon the \$1,000 liquidation preference, with such rate scheduled to increase by 2% on each April 1 beginning April 1, 2013. To the extent the Series A Preferred Stock is redeemed before September 28, 2012, no dividend will be payable. The Series A Preferred Stock is subject to mandatory redemption five years after issuance. Although the Company currently anticipates borrowing funds through a bank line of credit to fund a full redemption of the Series A Preferred Stock before September 28, 2012, there is no assurance that such financing will be available on terms acceptable to the Company or at all.

#### **Item 6. Exhibits**

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

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.

Date: August 8, 2012

BARRETT BUSINESS SERVICES, INC.  
(Registrant)

/s/ James D. Miller

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

EXHIBIT INDEX

Exhibit

10.1	Summary of Annual Cash Incentive Compensation Plan for Executives of the Registrant.
31.1	Certification of the Chief Executive Officer under Rule 13a-14(a).
31.2	Certification of the Chief Financial Officer under Rule 13a-14(a).
32	Certification pursuant to 18 U.S.C. Section 1350.
99.1	Description of Capital Stock of the Registrant.
101.	INS XBRL Instance Document *
101.	SCH XBRL Taxonomy Extension Schema Document *
101.	CAL XBRL Taxonomy Extension Calculation Linkbase Document *
101.	LAB XBRL Taxonomy Extension Label Linkbase Document *
101.	PRE XBRL Taxonomy Extension Presentation Linkbase Document *

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended and, otherwise are not subject to liability under those sections.

**Barrett Business Services, Inc.****Summary of Annual Cash Incentive Compensation Plan**

The Company believes that performance-based incentive compensation, or “Bonus”, is a necessary and proper part of Executive Compensation. Therefore, the executive officers are eligible for annual cash incentive bonus opportunities subject to attainment of corporate goals and individual performance objectives. The annual incentive bonus amounts and performance goals are set by the Compensation Committee (the “Committee”) of the Company’s Board of Directors (the “Board”) each year and are expressed as a percentage of the executive’s annual base salary. For 2012 the percentages range from 40% to 50% of base salary. The percentages of the total bonus opportunity assigned to corporate and individual goals are set by the Committee annually. For 2012, the percentages are apportioned 50% for corporate performance and 50% for individual performance.

***Bonus opportunities related to corporate level goals:***

The annual incentive performance goals related to corporate performance are defined by objectively measurable financial metrics, such as target levels of earnings before interest, taxes, depreciation and amortization (“EBITDA”), net earnings, gross revenues and similar measures. For 2012, the corporate component is tied directly to achievement of a specified EBITDA target level (50%) and a specified gross revenue target level (50%).

Achievement above or below the specified target level(s) for the financial metrics may result in an upward or downward adjustment in the bonus amount payable for corporate level goals. For each 1% above or below the target level, the bonus amount will be increased or reduced by 2.5%. If the Company fails to achieve a specified financial target at the 80% level or above, no part of the bonus associated with that metric is earned.

***Bonus opportunities related to individual performance objectives:***

The annual incentive bonus opportunities related to individual performance objectives for the executive officers are also set by the Committee each year. For 2012, individual performance makes up 50% of the target bonus opportunity. The individual performance objectives are based on achieving strategic and operational goals in functional areas for which the executive has responsibility. Individual performance objectives are tied to the officer’s role in achieving the Company’s strategic and operating goals and are set annually by the CEO in consultation with the individual officer and approved by the Committee. For the CEO, the individual performance objectives are related to factors such as the strategic positioning of the Company for future growth, maintaining financial stability, and establishing a positive corporate culture.

***Determination of Bonus Payouts***

The Committee determines the extent to which corporate level goals and individual performance objectives have been satisfied following the end of each fiscal (calendar) year, but no later than the March 15 following the end of the fiscal year. The bonus amounts payable for achievement of corporate

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performance goals and individual performance objectives may not exceed 150% of the respective bonus target amounts tied to those components. Any annual cash incentive bonus award approved for the CEO by the Committee is subject to review and ratification by the Board. Bonus amounts, if any, will be paid promptly following the Committee's determination. An executive must remain employed by the Company through the date of the Committee's determination to be eligible to receive a bonus.

**Certification of the Chief Executive Officer under Rule 13a-14(a)**

I, Michael L. Elich, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Barrett Business Services, 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 report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most-recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 8, 2012

/s/ Michael L. Elich

Michael L. Elich  
Chief Executive Officer

**Certification of the Chief Financial Officer under Rule 13a-14(a)**

I, James D. Miller, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Barrett Business Services, 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 report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report, based on such evaluation; and
  - d. disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most-recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: August 8, 2012

/s/ James D. Miller

James D. Miller  
Chief Financial Officer



CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350

In connection with the Quarterly Report of Barrett Business Services, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certify, pursuant to 18 U.S.C. § 1350, 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 results of operations of the Company.

/s/ Michael L. Elich

Michael L. Elich  
Chief Executive Officer  
August 8, 2012

/s/ James D. Miller

James D. Miller  
Chief Financial Officer  
August 8, 2012

A signed original of this written statement has been provided to Barrett Business Services, Inc. and will be retained by Barrett Business Services, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**BARRETT BUSINESS SERVICES, INC.**  
**DESCRIPTION OF CAPITAL STOCK**

Barrett Business Services, Inc. (the "Company"), is authorized to issue 500,000 shares of Preferred Stock, \$.01 par value, issuable in series, and 20,500,000 shares of Common Stock, \$.01 par value.

**Common Stock**

*Voting Rights.* Shares of Common Stock are entitled to one vote per share. Voting for directors is not cumulative. The affirmative vote of a majority of the outstanding shares of the voting capital stock of the Company is required to remove a director.

*Dividends.* Holders of Common Stock are entitled to dividends when, as and if declared by the Board of Directors out of funds legally available therefor (subject to the rights of holders of any preferred stock). The Company is not permitted to declare or pay dividends or distributions on, or purchase, redeem or retire, shares of Common Stock unless all accrued and unpaid dividends in respect of the Series A Nonconvertible, Non-Voting Redeemable Preferred Stock have been paid or set apart for payment for all prior dividend periods.

*Liquidation Rights.* Upon liquidation of the Company, after payment or provision for all liabilities and payment of any preferential amount in respect of Preferred Stock, holders of Common Stock are entitled to receive liquidating distributions of any remaining assets on a pro rata basis.

*Other.* Common Stock is not convertible into any other class of security, is not entitled to the benefit of any sinking fund provision and does not have any preemptive rights. All outstanding shares of Common Stock are fully paid and nonassessable.

**Preferred Stock**

The Board of Directors of the Company is authorized to issue Preferred Stock in one or more series, and to determine the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms or conditions of redemption of each series without any vote or action of the stockholders of the Company. The issuance of Preferred Stock in certain circumstances may have the effect of delaying or preventing a change in control of the Company. The issuance of Preferred Stock with voting and conversion rights may adversely affect the voting power of the holders of Common Stock.

**Series A Nonconvertible, Non-Voting Redeemable Preferred Stock**

Effective March 27, 2012, Article III of the Charter of the Company was amended to classify and designate 50,000 shares of Series A Nonconvertible, Non-Voting Redeemable Preferred Stock ("Series A Preferred Stock").

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*Voting Rights.* Holders of Series A Preferred Stock generally have no voting rights; however, the Company is not permitted to (A) amend its Charter so as to materially and adversely affect the rights of the Series A Preferred Stock or (B) create or issue any additional shares of Series A Preferred Stock (other than in satisfaction of dividends payable on the shares of Series A Preferred Stock issued on March 28, 2012 or thereafter as dividends on such shares) or any preferred stock that is senior to or on a parity with the Series A Preferred Stock with respect to dividends and liquidation preference, unless such action is approved by the affirmative vote of the holders of at least 85% of the Series A Preferred Stock outstanding at the time voting as a separate class.

*Dividends.* The initial dividend rate on the Series A Preferred Stock is 5% per annum, payable semi-annually at the Company's option in cash or additional shares of Series A Preferred Stock. The dividend rate increases by 2% annually beginning April 1, 2013 until all the Series A Preferred Stock has been redeemed. No dividends will be payable on shares of Series A Preferred Stock, if any, that are redeemed prior to September 28, 2012.

*Liquidation Rights.* Upon liquidation of the Company, the holders of the Series A Preferred Stock then outstanding are entitled to be paid, or have the Company declare and set apart for payment, out of the assets of the Company legally available for distribution to its stockholders, before any distribution of assets is made to holders of Common Stock, a liquidation preference per share of Series A Preferred Stock equal to the sum of (i) \$1,000 (as may be adjusted in accordance with the Series A Preferred Stock terms) and (ii) all accrued and unpaid dividends on such share.

*Other.* The Series A Preferred Stock is redeemable by the Company at any time at its option in whole or in part at the per share redemption price of \$1,000 plus all accrued and unpaid dividends. The Series A Preferred Stock is subject to mandatory redemption five years following the date the shares of Series A Preferred Stock were originally issued. The Series A Preferred Stock has no conversion rights.

#### **Anti-Takeover Provisions**

The Company's Charter and bylaws contain provisions that may have the effect of discouraging, delaying or preventing a change in control of the Company. Under these provisions, (i) the Board of Directors has the authority to issue up to 500,000 shares of Preferred Stock with such rights and preferences, including voting rights, as it may establish, without further approval by the Company's stockholders and (ii) the power to adopt, alter or repeal the Company's bylaws is vested solely in the Board of Directors.

#### **Maryland Control Share and Business Combination Statutes**

The Company is subject to the Maryland control share act (the "Control Share Act"). Under the Control Share Act, a person (an "Acquiring Person") who acquires voting stock in a transaction (a "Control Share Acquisition") which results in its holding voting power within specified ranges cannot vote the shares it acquires in the Control Share Acquisition ("control shares") unless voting rights are accorded to such control shares by the holders of two-thirds of

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the outstanding voting shares, excluding the Acquiring Person and the Company's officers and inside directors. The term Acquiring Person is broadly defined to include persons acting as a group.

An Acquiring Person may, but is not required to, submit to the Company an "Acquiring Person Statement" which delineates certain information about the Acquiring Person and its plans for acquiring the Company's stock and request the Company to call a special meeting of stockholders to act on the question of its voting rights.

If an Acquiring Person Statement is not delivered to the Company within ten days after a Control Share Acquisition or if the control shares are not accorded voting rights, the Company will have the right, subject to certain conditions, to redeem the control shares at fair value determined without regard to the absence of voting rights. If an Acquiring Person's control shares are accorded voting rights and its shares represent a majority or more of all voting power, all stockholders of the Company, other than the Acquiring Person, will have the right to receive "fair value" for their shares, which may not be less than the highest price paid per share by the Acquiring Person for its shares in the Control Share Acquisition.

The Company is also subject to the provisions of the Maryland General Corporation Law limiting the ability of certain Maryland corporations to engage in specified business combinations (the "Business Combination Act"). Subject to certain exceptions, the Business Combination Act prohibits a Maryland corporation from engaging in a business combination with a stockholder who, with its affiliates, owns 10% or more of the corporation's voting stock (an "Interested Stockholder") unless (i) the corporation's board of directors recommends the combination, (ii) stockholders holding 80% of the voting stock approve the business combination, and (iii) stockholders holding two-thirds of the voting stock not owned by the Interested Stockholder approve the business combination. In addition, an Interested Stockholder may not engage in a business combination with the corporation for a period of five years following the date the stockholder becomes an Interested Stockholder. "Business combination" is defined to include any merger with, any transfer of assets to, the provision of financial assistance to, and certain transactions involving the issuance of shares to, the Interested Stockholder. These provisions do not apply, however, to business combinations that are approved or exempted by the corporation's board of directors before the stockholder became an Interested Stockholder.