REMEDYTEMP INC
Form 10-Q
August 10, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 3, 2005
or

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

For the transition period from ___________ to ___________
Commission file number 0-5260
REMEDYTEMP, INC.
(Exact Name of Registrant as Specified in Its Charter)

California	**95-2890471**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
101 Enterprise Aliso Viejo, California (Address of Principal Executive Offices)	**92656 (Zip Code)**

Registrant s Telephone Number, Including Area Code: (949) 425-7600

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 þ No o

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

As of August 8, 2005, the Registrant had 8,801,066 shares of Class A Common Stock and 798,188 shares of Class B Common Stock outstanding.

RemedyTemp, Inc.
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* No information provided due to inapplicability of item.

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RemedyTemp, Inc.
PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CONSOLIDATED BALANCE SHEETS
(amounts in thousands)
(unaudited)

	July 3, 2005	October 3, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 25,647	$ 7,075
Investments		339
Restricted investments	3,627	19,161
Accounts receivable, net of allowance for doubtful accounts of $964 and $2,984, respectively	53,827	63,152
Prepaid expenses and other current assets	9,410	8,913
Prepaid income taxes	405	160
Total current assets	92,916	98,800
Fixed assets, net	10,048	10,589
Restricted cash and investments	21,898	21,925
Other assets	345	330
Intangible assets, net of accumulated amortization of $1,108 and $700, respectively	1,866	2,274
Goodwill	4,578	3,703
Total Assets	$131,651	$137,621
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 688	$ 4,225
Accrued workers compensation, current portion (Note 9)	13,760	15,036
Accrued payroll, benefits and related costs	15,077	17,938
Accrued licensees share of gross profit	2,244	2,745
Other accrued expenses	4,620	3,899
Capital lease obligations, short-term	22	
Total current liabilities	36,411	43,843
Capital lease obligations, long-term	116	
Other liabilities (Note 9)	33,310	30,267
Total liabilities	69,837	74,110
Commitments and contingent liabilities (Note 4)		

Shareholders equity:		
Preferred Stock, $0.01 par value; authorized 5,000 shares; none outstanding		
Class A Common Stock, $0.01 par value; authorized 50,000 shares; 8,801 and 8,778 shares issued and outstanding at July 3, 2005 and October 3, 2004, respectively	88	88
Class B Non-Voting Common Stock, $0.01 par value; authorized 4,530 shares; 798 and 800 shares issued and outstanding at July 3, 2005 and October 3, 2004, respectively	8	8
Additional paid-in capital	41,744	41,522
Unearned compensation	(2,723)	(3,737)
Accumulated other comprehensive loss	(152)	(68)
Retained earnings	22,849	25,698
Total shareholders equity	61,814	63,511
Total Liabilities and Shareholders Equity	$131,651	$137,621

See accompanying notes to consolidated financial statements.

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RemedyTemp, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(amounts in thousands, except per share amounts)
(unaudited)

	Three Months Ended		Nine Months Ended	
	July 3, 2005	**June 27, 2004**	**July 3, 2005**	**June 27, 2004**
Company-owned office revenues	$ 75,112	$ 85,537	$241,075	$243,153
Licensed franchise revenues	46,786	43,378	142,815	126,367
Franchise royalties and initial franchise fees	359	335	986	1,126
Total revenues	122,257	129,250	384,876	370,646
Cost of Company-owned office revenues	60,269	70,867	194,252	206,014
Cost of licensed franchise revenues	37,296	34,605	114,309	101,092
Licensees share of gross profit	6,418	5,900	19,277	17,044
Selling and administrative expenses	18,937	18,101	57,599	51,087
CIGA litigation	17	14	154	104
Depreciation and amortization	1,311	1,253	3,865	4,515
Loss from operations	(1,991)	(1,490)	(4,580)	(9,210)
Other income and expense:				
Interest expense	(192)	(102)	(498)	(308)
Interest income	505	244	1,037	781
Other, net	250	146	749	521
Loss before income taxes	(1,428)	(1,202)	(3,292)	(8,216)
Provision for (benefit from) income taxes	18	106	(443)	433
Net loss	$ (1,446)	$ (1,308)	$ (2,849)	$ (8,649)
Loss per share basic and diluted:				
Net loss per share basic and diluted	$ (0.16)	$ (0.14)	$ (0.32)	$ (0.96)
Weighted average shares:				
Basic and diluted	9,054	9,024	9,034	9,021

See accompanying notes to consolidated financial statements.

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RemedyTemp, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in thousands)
(unaudited)

	For the Nine Months Ended	
	July 3, 2005	June 27, 2004
Cash flows from operating activities:		
Net loss	$ (2,849)	$ (8,649)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation and amortization	3,865	4,515
(Recovery of) provision for losses on accounts receivable	(81)	720
Stock-based compensation expense	1,142	697
Gain on sale of available-for-sale investments	(5)	(57)
Changes in assets and liabilities:		
Trading investments	(466)	(469)
Accounts receivable	9,421	4,898
Prepaid expenses and other current assets	(757)	(2,172)
Other assets	(15)	940
Accounts payable	(3,537)	(3,059)
Accrued workers compensation	1,767	4,245
Accrued payroll, benefits and related costs	(2,864)	(1,192)
Accrued licensees share of gross profit	(504)	(94)
Other accrued expenses	720	181
Prepaid income taxes	(245)	(314)
Net cash provided by operating activities	5,592	190
Cash flows from investing activities:		
Purchase of fixed assets	(2,518)	(1,320)
Purchase of available-for-sale investments	(8,666)	(28,023)
Proceeds from sale of available-for-sale investments	10,129	36,533
Net (increase) decrease in restricted cash and investments	14,805	(14,347)
Acquisition of franchises	(875)	(1,443)
Net cash provided by (used in) investing activities	12,875	(8,600)
Cash flows from financing activities:		
Proceeds from stock option activity		8
Proceeds from Employee Stock Purchase Plan activity	94	113
Net cash provided by financing activities	94	121
Effect of exchange rate changes in cash	11	(29)
Net increase (decrease) in cash and cash equivalents	18,572	(8,318)

Cash and cash equivalents at beginning of period	7,075	13,236
Cash and cash equivalents at end of period	$25,647	$ 4,918
Supplemental disclosure of non-cash activities:		
Purchase of equipment with capital lease	$ 138	$
Issuance of common shares to Non-Employee Director	$ 127	$
Forfeiture of restricted stock	$	$ 1,345

See accompanying notes to consolidated financial statements.

RemedyTemp, Inc.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(amounts in thousands, except per share amounts)
(unaudited)

1. Basis of Presentation

The consolidated financial statements include the accounts of RemedyTemp, Inc. and its wholly owned subsidiaries (collectively referred to herein as the Company or Remedy). These financial statements have been prepared in accordance with principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). In the opinion of management, the accompanying unaudited consolidated financial statements contain all material adjustments (consisting of normal recurring adjustments) necessary to fairly state the financial position of the Company as of July 3, 2005, and its results of operations and cash flows for the thirty-nine weeks ended July 3, 2005 and June 27, 2004. All significant intercompany accounts and transactions have been eliminated in consolidation. As permitted under the applicable rules and regulations of the SEC, these financial statements do not include all disclosures and footnotes normally included with annual consolidated financial statements and, accordingly, should be read in conjunction with the consolidated financial statements, and the notes thereto, included in the Company s Annual Report on Form 10-K filed with the SEC on December 7, 2004, for the year ended October 3, 2004. The results of operations for the three and nine fiscal months ended July 3, 2005 may not be indicative of the results of operations that can be expected for the full year.

Fiscal quarter

The Company s fiscal quarters include 13 or 14 weeks. The current quarter ended July 3, 2005 consisted of 13 weeks. The remaining quarter of fiscal 2005 includes 13 weeks and will end on October 2, 2005. The fourth quarter of fiscal 2004 ended October 3, 2004 included 14 weeks.

Reclassifications

Certain amounts in the prior year s consolidated financial statements have been reclassified to conform to the current year presentation. The reclassifications did not have an impact on the net loss or total shareholders equity.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

2. Stock-based Incentive Compensation

The Company follows the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and, accordingly, accounts for its stock-based compensation plans using the intrinsic value method under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) and related interpretations.

In arriving at an option valuation, the Black-Scholes model considers, among other factors, the expected life of an option and the expected volatility of the Company s stock price. For pro forma purposes, the estimated fair value of the Company s stock-based awards to employees is amortized over their respective vesting periods.

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RemedyTemp, Inc.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(amounts in thousands, except per share amounts)
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The following table illustrates the effect on net loss and net loss per share had compensation expense for the employee stock-based plans been recorded based on the fair value method using the Black-Scholes option pricing model under SFAS No. 123, as amended:

	For the Three Months Ended		For the Nine Months Ended	
	July 3, 2005	June 27, 2004	July 3, 2005	June 27, 2004
Net loss, as reported	$(1,446)	$(1,308)	$(2,849)	$(8,649)
Add: stock-based compensation included in net loss	429	177	1,142	697
Deduct: total stock-based employee compensation expense determined under fair value based method	(518)	(298)	(1,412)	(1,051)
Net loss, as adjusted	$(1,535)	$(1,429)	$(3,119)	$(9,003)
Basic and diluted net loss per share:				
As reported	$ (0.16)	$ (0.14)	$ (0.32)	$ (0.96)
As adjusted	$ (0.17)	$ (0.16)	$ (0.35)	$ (1.00)

The following table sets forth the components of stock-based compensation expense include in net loss:

	For the Three Months Ended		For the Nine Months Ended	
	July 3, 2005	June 27, 2004	July 3, 2005	June 27, 2004
Restricted stock-based compensation expense	$ 340	$ 158	$ 1,016	$ 608
Phantom stock-based compensation expense	76		76	
Board of Directors stock-based compensation expense	13	19	49	88
Other stock-based compensation expense			1	1
Total	$ 429	$ 177	$ 1,142	$ 697

The tax benefit related to the options granted during the three and nine fiscal months ended July 3, 2005 and June 27, 2004 would generally be recorded at the Company s federal and state statutory rate of approximately 40%. However, due to the full valuation allowance on the deferred tax assets, as discussed in Note 14, any expense related to stock options would result in a net zero tax effect.

3. Shareholders Equity

Additional Paid-in Capital

The following table summarizes the activity in additional paid-in capital:

	July 3, 2005
Beginning balance	$41,522
Issuance of common shares to Non-Employee Director	127
Activity of Employee Stock Purchase Plan	94
Other	1
Ending balance	$41,744

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RemedyTemp, Inc.
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Comprehensive Loss

The components of comprehensive loss, net of taxes are as follows:

	Three Fiscal Months Ended		Nine Fiscal Months Ended	
	July 3, 2005	June 27, 2004	July 3, 2005	June 27, 2004
Net loss	$(1,446)	$(1,308)	$(2,849)	$(8,649)
Other comprehensive income (loss):				
Change in unrealized gain (loss) on investments	89	(270)	(99)	(284)
Reclassification adjustment for net realized gain included in net loss	(5)	(7)	(5)	(57)
Translation adjustments	(13)	(32)	20	(33)
Total comprehensive loss	$(1,375)	$(1,617)	$(2,933)	$(9,023)

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	July 3, 2005	October 3, 2004
Accumulated unrealized loss on investments	$ (219)	$ (115)
Accumulated translation adjustments	67	47
Total accumulated other comprehensive loss	$ (152)	$ (68)

Registration Statement

The Company has in effect a universal shelf registration statement on Form S-3 filed with the SEC. The universal shelf registration statement permits the Company to sell, in one or more public offerings, shares of its Class A common stock, shares of preferred stock, debt securities, depository shares and/or warrants, or any combination of such securities, for proceeds in an aggregate amount of up to $30,000. Specific terms and prices will be determined at the time of any offering and included in a related prospectus supplement to be filed with the SEC. To date no securities have been issued pursuant to the universal shelf registration.

4. Commitments and Contingent Liabilities

Litigation

Lindsay Welch-Hess v. Remedy Temporary Services, Inc.

Commencing in March 2003, the Company was sued in an action entitled *Lindsay Welch-Hess v. Remedy Temporary Services, Inc.*, in San Diego Superior Court. The complaint sought damages under various employment tort claims, including sexual harassment and retaliation stemming from a four-day employment relationship. The complaint also sought damages for unpaid wages under the California Labor Code. The plaintiff later amended the complaint to assert class claims for unpaid wages with respect to certain aspects of the application process. The complaint asserted additional class claims alleging failure to compensate persons assigned to one of Remedy s clients.

In November 2004, the Court certified a class consisting of all persons in California who, since October 1999, have applied to the Company for placement in a temporary job, regardless of whether they were ever placed in a temporary assignment by the Company (the Remedy class). The Court certified a second class consisting of all persons in California who, since October 1999, were hourly employees hired by Remedy and assigned to a particular client (the training class).

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
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On February 11, 2005, the Company filed two motions for summary judgment related to the Remedy class and the training class. On May 31, 2005, the Court denied, in part, the Company s motion for summary judgment related to the Remedy class, which allows that class to pursue the claim for unpaid compensation. On June 27, 2005, the Company filed a writ in Division One of the Fourth Appellate District seeking an order vacating the denial of Remedy s summary judgment motion related to the Remedy class. No ruling on the writ has been made. On July 29, 2005, the Court granted Remedy s motion for summary judgment related to the training class and allowed plaintiffs to recover attorneys fees. Although the Company intends to vigorously defend this case, at this time, the Company cannot reasonably assess the amount of any potential damages.

CIGA

In early 2002, as a result of the liquidation of Remedy s former workers compensation insurance carrier, Reliance National Insurance Company (Reliance), the California Insurance Guarantee Association (CIGA) began making efforts to join some of the Company s clients and their workers compensation insurance carriers (collectively, Clients), in pending workers compensation claims filed by Remedy employees. At the time of these injuries, from July 22, 1997 through March 31, 2001, Remedy was covered by workers compensation policies issued by Reliance. The Company believes that under California law, CIGA is responsible for Reliance s outstanding liabilities. On April 5, 2002, the California Workers Compensation Appeals Board (WCAB), at Remedy s request, consolidated the various workers compensation claims in which CIGA sought to join Remedy s Clients, and agreed to stay proceedings on those claims pending resolution of the issue of CIGA s obligations to satisfy Reliance s obligations to Remedy s employees. The WCAB selected a single test case from the consolidated pending cases in which to decide whether CIGA is responsible for the claims of Remedy s employees, or can shift such responsibility to the Clients. The trial occurred on September 20, 2002. The WCAB Administrative Law Judge ruled in favor of CIGA, thus allowing the pending workers compensation matters to proceed against the Clients. Remedy then filed a motion for reconsideration of the Administrative Law Judge s decision by the entire WCAB. On March 28, 2003, the WCAB affirmed the ruling of the Administrative Law Judge. Thereafter, in May 2003, the Company filed a petition for writ of review of the WCAB s decision in the California Court of Appeal. The WCAB continued the stay in effect since April 5, 2002, thus preventing CIGA from proceeding until the writ proceeding was concluded. In January 2004, the Court of Appeal granted the Company s petition and undertook to review the WCAB s decision. The Court of Appeal heard oral argument in the matter on July 9, 2004.

On October 20, 2004, the Court of Appeal affirmed the WCAB s decision. On November 18, 2004, the Court of Appeal granted the Company s petition for rehearing and requested additional briefing on this matter. The Court of Appeal heard oral argument on April 15, 2005. On July 25, 2005, the Court of Appeal issued its decision finding that CIGA should not be dismissed and that the insurance held by Remedy s Client did not provide other available insurance for the workers compensation claim. CIGA may seek further appellate review of this decision.

Despite the Court of Appeal s recent decision, in the event of a final unfavorable outcome, Remedy may be obligated to reimburse certain Clients and believes that it would consider reimbursement of other Clients for actual losses incurred as a result of an unfavorable ruling in this matter. If CIGA is permitted to join Remedy s Clients, thus triggering the Clients insurance carriers obligation to respond to the claims of Remedy s employees, the Company believes that the direct financial exposure to Remedy becomes a function of the ultimate losses on the claims and the impact of such claims, if any, on the Clients insurance coverage, potentially including but not limited to the Clients responsibility for any deductibles or retentions under their own workers compensation insurance. The Company has received data from the Third Party Administrator (TPA) handling the claims for CIGA. Such data indicates claims of approximately $31,300 as of April 3, 2005. The losses incurred to date represent amounts paid to date by the trustee and the remaining claim reserves on open files.

In the fourth quarter of fiscal 2004, the Company recorded a $5,877 charge to operating income related to the CIGA case. The Company does not currently expect to change the amount of this charge as a result of the July 25, 2005 ruling, until final resolution of the case. This amount represents the Company s estimate on the basis of a review of known information and was established for costs associated with the indemnification of certain Clients for losses they may suffer as a result of a final unfavorable outcome. The information reviewed included customer contracts, review of the loss run received from the TPA handling the claims, actuarial development of the reported claim losses, estimates of customer insurance coverage, and other applicable information. The amount of the charge is, therefore, subject to change as more

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
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information becomes available to the Company. The Company recorded $154 in legal expenses for CIGA litigation costs during the nine fiscal months ended July 3, 2005. Additionally, the Company reclassified $104 of legal expenses related to the CIGA matter that were incurred during the nine fiscal months ended June 27, 2004 from selling and administrative expense to CIGA litigation. In the event of a final unfavorable outcome, the Company may also choose to reimburse certain Clients that did not enter into contracts with the Company or whose contracts may not have included indemnification language. These costs will be treated as period costs and will be charged to the consolidated statements of operations in the period management decides to make any goodwill payments to Clients. Management s current estimate of future goodwill payments is a range of $2,000 to $3,000. This estimate is subject to change.

Other Litigation

From time to time, the Company becomes a party to other litigation incidental to its business and operations. The Company maintains insurance coverage that management believes is reasonable and prudent for the business risks that the Company faces. Based on current available information, management does not believe the Company is party to any other legal proceedings that are likely to have a material adverse effect on its business, financial condition, cash flows or results of operations.

Other Contingency

In late 2003, the Company was notified that it may have underpaid certain payroll-related tax liabilities by approximately $2,000 for the period from January 1, 2003 through September 30, 2003. Based on its evaluations and after consultation with outside counsel, the Company believes that the methodology the Company used to calculate these taxes was in compliance with applicable law. The Company is currently working with outside counsel to resolve these matters. As of July 3, 2005, the Company has accrued $983 in connection with the potential settlement of these payroll-related tax matters.

5. Earnings Per Share

Basic earnings per share (EPS) is calculated using net loss divided by the weighted average number of common shares outstanding during the period. Diluted EPS is calculated similar to basic EPS except that the weighted average number of common shares is increased to include the number of additional common shares that would have been outstanding if the potential dilutive common shares, such as options, had been issued and restricted shares had vested.

Potential common shares (including applicable outstanding options, restricted shares and shares in trust of 1,254 and 1,293 for the three fiscal months ended July 3, 2005 and June 27, 2004, respectively, and 1,224 and 1,298, for the nine fiscal months then ended, respectively) have been excluded from the calculation of diluted shares because the effect of their inclusion would be anti-dilutive.

6. Investments

The Company accounts for its investments in accordance SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. At the time of sale, the cost of mutual fund investments are determined using the average cost method and fixed income securities cost is based upon specific identification. All investments are carried at fair value. The following presents the classification of the Company s investments:

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RemedyTemp, Inc.