

LABOR READY INC
Form 10-K
February 20, 2007

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

FORM 10-K

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

For the fiscal year ended: December 29, 2006

or

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

Commission File Number: 001-14543

LABOR READY, INC.

(Exact name of Registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

1015 A Street, Tacoma, Washington
(Address of principal executive offices)

91-1287341
(IRS Employer
Identification No.)

98402
(Zip Code)

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

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

Title of each class
Common Stock without par value

Name of each exchange on which registered
The New York Stock Exchange

Securities registered under Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value (based on the NYSE quoted closing price) of the common stock held by non-affiliates of the Registrant as of the last business day of the second fiscal quarter, June 30, 2006, was approximately \$1,171 million.

As of February 12, 2007, there were 50,690,227 shares of the Registrant's common stock outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report is incorporated by reference from the Registrant's definitive proxy statement, relating to the Annual Meeting of Shareholders scheduled to be held May 16, 2007, which definitive proxy statement will be filed not later than 120 days after the end of the fiscal year to which this report relates.

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LABOR READY, INC.

FORM 10-K

PART I.

This Form 10-K contains forward-looking statements. These statements relate to our expectations for future events and future financial performance. Generally, the words anticipate, expect, intend and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. These statements are only predictions. Actual events or results may differ materially. Factors which could affect our financial results are described in Item 1A below and in Item 7 of Part II of this Form 10-K. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. We undertake no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

Comment regarding our fiscal year end: Effective fiscal 2006, the Company changed its fiscal year from one ending on the Friday closest to December 31st to the last Friday in December. The purpose for the change is to improve comparability of fiscal years. As a result of the change, New Year's Day (the Holiday) will occur once in each fiscal year, whereas under the prior policy the Holiday periodically fell twice in the same fiscal year. The Company's consolidated financial statements will continue to be presented on a 52/53-week fiscal year end basis. In fiscal years consisting of 53 weeks, the final quarter will consist of 14 weeks while in 52-week years all quarters will consist of 13 weeks. Fiscal years 2006, 2005 and 2004 were 52-week years. The current year-end of Friday, December 29, 2006 is the same as it would have been under the prior policy.

Labor Ready, the Company, we, us, our and similar references refer to Labor Ready, Inc. and our subsidiaries.

Item 1. BUSINESS

a) Introduction and General Developments

We were incorporated in 1985 under the laws of the State of Washington and began operations in 1989. We are an international provider of temporary employees for manual labor, light industrial, and skilled construction trades, operating under the brand names of Labor Ready, Labour Ready, Workforce, Spartan Staffing, and CLP Resources. Annually, we serve more than 300,000 customers and put approximately 600,000 people to work through our 912 branches located in all 50 of the United States, Canada, Puerto Rico and the United Kingdom.

Our customers are primarily small- to mid-sized businesses in the construction, warehousing, hospitality, landscaping, transportation, light manufacturing, retail, wholesale, facilities and sanitation industries. These businesses typically require temporary employees for various types of manual work. We locate our branches in areas easily accessible to temporary employees, and within convenient commuting distances to customers needing manual labor. We believe our ability to provide a large number of temporary employees on short notice, usually the same day as requested, provides us with a competitive advantage.

The following table lists the number of branches in each country open at the end of each of the last five years.

Labor Ready Branches by Country

	Year End				
	2006	2005	2004	2003	2002
United States (including Puerto Rico)	825	801	733	698	686
Canada	40	36	35	36	31
United Kingdom	47	50	47	45	31
Total	912	887	815	779	748

A key element of our business model is flexibility and scalability which allows us to respond to changes in the economy and other business opportunities. We plan to open approximately 20 new branch locations in 2007, including 10 CLP Resources branches, 5 Labor Ready branches and 5 Spartan Staffing branches in the United States. We may alter the pace of our expansion based on future branch performance, market conditions, and acquisitions, should they occur. We continually analyze individual branch results, and may close branches in 2007 which do not meet specific performance standards. We will continue to evaluate acquisition opportunities within and complementary to the markets we currently serve.

b) Financial Information about Business Segments

Our operations qualify to be reported as one reportable segment. Our operations are all in the industrial staffing sector which serve similar customers, provide similar services, and have similar expected operating margins. Please see Item 8 of Part II of this Form 10-K for our consolidated financial information.

c) Narrative Description of Our Business

TEMPORARY STAFFING INDUSTRY

The temporary staffing industry evolved out of the need to minimize the inconvenience and expense of hiring and administering permanent employees in response to temporary changes in business conditions. The demand for temporary employees has been driven primarily by the need to satisfy peak production requirements and to temporarily replace full-time employees absent due to illness, vacation or abrupt termination. Competitive pressures have forced businesses to focus on reducing costs, including converting fixed, permanent labor costs to variable or flexible costs.

The temporary staffing industry includes a number of sectors focusing on business needs that vary widely in duration of assignment and level of technical specialization. We operate primarily within the short-term, industrial area of the temporary staffing industry. We feel this sector is highly fragmented and presents opportunities for larger, well-capitalized companies to compete effectively. Our competitive advantages include worker safety programs and risk management, proprietary systems and automation that efficiently process a high volume of transactions and coordinate multi-location activities, management and employee development programs, multi-location servicing of regional and national customers, and leverage of infrastructure support of multi-location activities.

Industry factors that impact our working capital include the fact that we generally pay our temporary employees on a daily basis, bill our customers weekly and, on average, collect monthly. Additionally, we are substantially self-insured for workers' compensation claims originating in the majority of the states in which we do business. As such, we are required by our insurance carriers and certain state workers' compensation programs to collateralize our potential workers' compensation obligation before the work is performed using cash and cash-backed instruments, irrevocable letters of credit, or surety bonds. More detailed discussion of the impact of those collateral requirements on our working capital can be found in Item 7 of Part II of this Form 10-K - Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources.

OUR STRATEGY

Our strategy is to grow our position as one of the leading providers of manual labor, light industrial and skilled construction trades (Blue collar) staffing. The focus of our strategy is as follows:

- **Grow same branch revenues and profits.** Our strategy is to increase revenue and operating margin in each branch by expanding our services to existing customers and by aggressively expanding the number and mix of customers served. We are committed to only opening branches that can quickly reach or exceed performance standards, and closing branches that are under-performing. This strategy improves profitability by increasing average revenue per branch and the average revenue per employee. We are focused on improving our branch manager tenure through effective compensation programs, enhanced and targeted training and meaningful mentoring and development. We are continually working to improve all aspects of customer service and we are diligently monitoring and controlling our pricing and costs. A key area of focus has been and will continue to be reducing overall workers compensation expense through our safety and risk management programs. Same branch revenue growth for 2006 was 4.0% bringing average revenue per branch to approximately \$1.5 million. We believe our branches, on average, can manage average annual sales volume in excess of \$2.5 million per year without a significant increase in fixed costs. In support of this strategy, we invested in sales training and management in 2006 and believe continued focus in this area is crucial to successfully increasing our average branch revenue in the future.
- **Expand into new markets.** We continue to seek opportunities to expand the reach of our brands into new markets. We intend to establish a presence, where appropriate, in small- to medium-sized domestic markets, generally with populations that average about 50,000 people or more. These new markets typically are no closer than 25 miles to our nearest branch. During 2006, we opened 50 new branches with a little over half of these openings occurring in the CLP Resources and Spartan Staffing brands. At the end of 2006, CLP Resources had 68 branches, Spartan Staffing had 28 branches and Workforce had 20 branches. We will continue to grow all brands through new branch openings in 2007. New branch openings will focus on growing a national presence for our Spartan Staffing and CLP Resources brands by opening approximately 5 new Spartan Staffing branches and 10 new CLP Resources branches in 2007. We also plan to open 5 new Labor Ready branches to meet the growing demand for on demand manual labor.
- **Expand our service offerings.** We plan to continue our efforts in expanding our services and brands. At the end of 2006 we were operating 68 CLP Resources branches, 28 Spartan Staffing branches and 20 Workforce branches resulting from our acquisitions. We will continue to evaluate acquisition opportunities within and complementary to the markets we currently serve.

OUR OPERATIONS

Branches. Branch locations are generally staffed with a branch manager and one or more customer service representatives. Larger branches are staffed with more employees. Branches generally open by 5:30 a.m. local time and remain open until the last temporary employee is paid. Typically, temporary employees come to the branch in the morning to indicate their availability for assignment. During the early morning hours, branch staff coordinate incoming customer work orders and assign the available temporary employees to the job openings for the day. Most of the job openings are requested on short notice, many the same day as the temporary employees are needed at the job site. Work assignments are filled by the branch manager who strives to match the customer needs with the skills and experience of the temporary worker.

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We believe that one of the most critical factors determining the success of a branch is identifying and retaining an effective branch manager. Each branch manager has the responsibility for satisfying existing customers and marketing and sales efforts to attract new customers. Each branch manager has the responsibility for managing the operations of the branch which include the recruiting, daily dispatch and payment of temporary employees. Other key responsibilities include accident prevention, collection of accounts receivable and cost control. We commit substantial resources to the training, development, and operational support of our branch managers.

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Our Customers. The majority of our customers require temporary employees for short-term projects such as lifting, hauling, cleaning, assembling, digging, painting and other types of manual or unskilled work. We currently derive our revenue from a large number of customers and we are not dependent on any individual customer for more than 2% of our annual revenue. During 2006, we served over 300,000 customers. Our ten largest customers accounted for approximately 4% of total revenue in 2006 and approximately 4% and 5% of total revenue in 2005 and 2004, respectively. While a single branch may derive a substantial percentage of its revenue from an individual customer, the loss of that customer would not have a significant impact on our overall revenue.

Many customers use us to screen prospective employees for future permanent hires. Because we typically do not charge a fee if a customer hires our temporary employee, customers have the opportunity to observe the prospective employee in an actual working situation, minimizing the expense of employee turnover and recruiting fees. We recruit temporary employees daily so that we can be responsive to the planned as well as unplanned needs of the customers we serve. Our customers know we can respond quickly to their labor needs. Under our satisfaction guaranteed policy, temporary employees unsatisfactory to our customer are promptly replaced and the customer is not charged for their time if the customer notifies us within the first two hours of work. Adjustments related to all customer credits, including those related to our satisfaction guarantee, totaled 0.5%, 0.5% and 0.4% of revenue for 2006, 2005 and 2004, respectively.

Our Temporary Employees. During 2006, we put approximately 600,000 people to work. Most temporary employees find our Work Today, Paid Today policy appealing and arrive at the branch early in the morning motivated to put in a day's work and receive their pay at the end of the day. Our temporary employees are aware that we typically do not charge a fee if a customer decides to offer them a full-time position. The possibility of locating a full-time position serves as an added incentive to our temporary employees. We attract our pool of temporary employees through flyers, newspaper advertisements, branch displays and word of mouth. We believe our focus on locating branches in areas convenient for our temporary employees, with ready access to public transportation, is particularly important in attracting temporary employees.

Management, Employees and Training. At the end of 2006, we had approximately 3,500 permanent employees. We are committed to retaining our employees with effective compensation programs, on-going training, development and career growth opportunities.

New branch managers typically undergo four weeks of on-the-job training at a branch and one week of training at our corporate offices in Tacoma, Washington. Training professionals have developed a curriculum, training manuals, and on-line instruction modules, which include topics such as sales, marketing, recruiting and personnel policies, compliance policies, safety, workers' compensation administration and credit and collections. Customer service representatives receive on-the-job training at the branch where they work, supplemented by a computerized training program.

Branch managers report to district managers who in turn report to area directors. We have a formalized leadership development and selection process for all district manager positions and above designed to identify and promote as many possible candidates from within the Company before looking to potential external candidates.

Sales and Marketing. Each branch manager is responsible for their own sales, customer service and marketing efforts in their local market area in coordination with our corporate National Sales Department and Marketing Department. All branch employees are involved in sales and customer relations. We have a National Sales Department focused on generating and cultivating relationships with large customers who concurrently use multiple branches. Local branch marketing programs include telemarketing, direct-mail campaigns, yellow-page advertising, word of mouth, and radio and billboard advertising.

Worker Safety. We are committed to our temporary employees' safety and reducing workplace injuries:

- Branch employees are responsible for screening new and existing customers and terminating those relationships if necessary. They are trained to discuss job safety parameters with customers on incoming work order requests. Branch managers conduct job site visits for customer job orders and periodic spot checks of existing customers to review safety conditions at job sites. Temporary employees are encouraged to report unsafe working conditions to us.
- We have processes to qualify temporary employees for dispatch and match these employees to suitable jobs.
- We maintain an inventory of basic safety equipment at our branches. Standard equipment includes hard hats, metal-toed boots, gloves, back braces, earplugs, and safety goggles. Appropriate equipment is checked out to temporary employees based on the type of work to be performed. For example, most construction jobs require steel-toed boots and a hard hat.
- We employ a group of safety professionals who serve as a technical resource to our branch personnel, temporary employees, and customers in recommending changes to our operating and work practices to reduce the frequency of

injuries and reinforce our culture of safety first . We will continue to assess the need for additional safety professionals and anticipate adding additional personnel in various operating areas in 2007.

- We have developed additional reporting and accountability practices to monitor accident trends in our operations.

Workers Compensation Program. We provide workers compensation insurance for our temporary and permanent employees. Our workers compensation insurance policies must be renewed annually. We renewed our coverage with American International Group, Inc. (AIG) for occurrences during the period from July 2006 through June 2007. While we have primary responsibility for all claims, our insurance coverage provides reimbursement for certain losses and expenses beyond the deductible limits. For workers compensation claims originating in self-insured states, the majority of our current workers compensation insurance policies cover claims for a particular event above a \$2.0 million deductible, on a per occurrence basis. This results in our being substantially self-insured. See Item 7 of Part II and the notes to our consolidated financial statements under Item 8 of Part II of this Form 10-K, for additional discussion regarding the impact of collateral requirements on workers compensation.

Information Technology Systems. We have developed our own proprietary front-end software system to process all required credit, billing, collection and temporary worker payroll, together with other information and reporting systems necessary for the management of hundreds of thousands of temporary employees and operations in multiple locations. The system maintains all of our key databases, from the tracking of work orders to payroll processing to maintaining worker records. The current system regularly exchanges all point of sale information between the corporate headquarters and the branches, including customer credit information and outstanding receivable balances. Branch staff can run a variety of reports on demand, such as receivables aging, margin reports and customer activity reports. Area directors and district managers are able to monitor their territories from remote locations.

Our system also provides us with key internal controls. Work order tickets are entered into the system at the branch level. Payroll checks cannot be issued at a branch without a corresponding work ticket on the computer system. When a temporary employee is paid, the customer s weekly invoice and the branch receivables ledger are automatically updated. Printed checks have watermarks and computer-generated signatures that are difficult to duplicate. Most cash receipts are received in lockbox accounts and are matched to customers receivable records using an automated data capture system.

Cash Dispensing Machines (CDMs). Temporary employees are paid their wages by payroll check unless they specifically request a voucher that can be redeemed immediately for cash from a CDM in exchange for a transaction fee. For those employees who elect to receive a voucher instead of a check, the CDM dispenses their net pay less the change and a \$1 transaction fee for the use of the CDM. Revenue from the CDMs are substantially offset by the direct costs of the CDM program, which include depreciation, taxes, cash delivery and servicing, maintenance, supplies, insurance and other cash handling support costs. However, the primary purpose of the CDM program is to provide an additional service to our temporary employees which most of our competitors do not offer and which we believe enhances our ability to attract temporary employees.

New Branch Openings. We identify desirable areas for locating new branches using a demographic model that analyzes the potential supply of temporary employees and customer demand based on a zip code resolution of employment figures, demographics and the relative distance to our nearest existing branch. In addition, we locate branches in areas convenient for our temporary employees, which are near public transportation, and have parking available. After establishing a branch in a metropolitan area, we have often clustered additional locations within the same area if demand for our services was strong enough. Multiple locations in a market reduce both opening costs and operating risk for new branches because direct mail and other advertising costs are spread among more branches and because the

new branch benefits from existing customer relationships and established Labor Ready brand recognition.

We have standardized the process of opening new branches. When we open a new branch, we invest in recruiting and training new permanent employees, equipping the branch, and funding losses during its start-up growth period. On average, we incurred start-up costs, including net operating losses, of approximately \$90,000 per branch opened in 2006. New branches are expected to generate revenue sufficient to cover their operating costs within one to two years. The volume necessary for profitable operations ranges from \$450,000 to \$750,000 per year, depending on the brand. Branches in operation at the end of the year and open for at least one full year generated average annual revenue of approximately \$1.5 million per branch in 2006.

SEASONALITY

Our business experiences seasonal fluctuation. Construction and construction related businesses and, to a lesser degree, other customer businesses typically increase activity in spring, summer and early fall months and decrease activity in late fall and winter months. Inclement weather can slow construction and landscaping activities in such periods. As a result, we generally experience an increase in temporary labor demand in the spring, summer and early fall months, and lower demand in the late fall and winter months. Additionally, our gross profit has generally fluctuated as our mix of business changes from quarter to quarter.

COMPETITION

The short-term, manual labor sector of the temporary services industry is highly competitive with limited barriers to entry. Several very large full-service and specialized temporary staffing companies, as well as small local companies, compete with us in the staffing industry. A large percentage of temporary staffing companies serving the manual labor sector of the industry are local operations with fewer than five branches. Within local or regional markets, these firms actively compete with us for business. In most areas, no single company has a dominant share of the market. One or more of these competitors may decide at any time to enter or expand their existing activities in the short-term labor market and provide new and increased competition to us. While entry to the market has limited barriers, lack of working capital frequently limits the growth of smaller competitors.

We believe that the primary competitive factors in obtaining and retaining customers are the cost of temporary labor, the quality of the temporary employees provided, the responsiveness of the temporary staffing company to provide the requested amount of temporary employees on time, and the number and location of branches. Competition in some markets is intense, particularly with regard to recruiting workers, and these competitive forces limit our ability to raise prices to our customers. For example, competitive forces have historically limited our ability to raise our prices to immediately and fully offset increased costs of doing business, including increased labor costs, costs for workers compensation and state unemployment insurance. As a result of these forces, we have in the past faced pressure on our operating margins. See Item 1A below of this Form 10-K - Risk Factors.

GOVERNMENT REGULATIONS

We are in the business of employing people and placing them in the workplaces of other businesses. As a result, we are subject to a number of federal, state and local laws and regulations regulating our industry. Some of the most important areas of regulation are listed below.

Wage and Hour Regulation. We are required to comply with applicable state and federal wage and hour laws. These laws require us to pay our employees minimum wage and overtime at applicable rates. When our temporary employees are employed on public works projects we are generally required to pay prevailing wages and to comply with additional reporting obligations.

Regulation Concerning Equal Opportunity. We are required to comply with applicable state and federal laws prohibiting harassment and discrimination on the basis of race, gender and other legally-protected factors in the employment of our temporary and permanent employees.

Workplace Safety. We are subject to a number of state and federal statutes and administrative regulations pertaining to the safety of our employees. These laws generally require us to provide general safety awareness and basic safety equipment to our temporary employees.

Proposed New Regulations. See Risk Factors in Item 1A below. We are continually subject to the risk of new regulations which could harm our business.

PATENTS AND TRADEMARKS

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Our business is not presently dependent on any patents, licenses, franchises or concessions. Labor Ready, Spartan Staffing, CLP Resources and service marks such as Work Today, Paid Today and Work Today, Cash Today are registered with the U.S. Patent and Trademark Office. We have also been granted a patent by the U.S. Patent and Trademark authorities for the system of controlling a network of CDMs for the disbursement of temporary employee payroll.

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d) Financial Information About Geographic Areas

The following table depicts our revenue derived from within the United States and that derived from other countries for the past three years (in thousands).

	2006		2005		2004	
United States (including Puerto Rico)	\$ 1,263,642	93.7 %	\$ 1,155,494	93.5 %	\$ 965,454	92.5 %
Canada and the United Kingdom	85,476	6.3 %	80,576	6.5 %	78,782	7.5 %
Total revenue from services	\$ 1,349,118	100 %	\$ 1,236,070	100 %	\$ 1,044,236	100 %

The following table depicts our net property and equipment located in the United States and the net property and equipment located in other countries for the past three years (in thousands).

	2006	2005	2004
United States (including Puerto Rico)	\$		