

HUDSON HIGHLAND GROUP INC

Form 10-K

March 15, 2006

Table of Contents

---

# 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 31, 2005**

OR

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

COMMISSION FILE NUMBER 000-50129

---

## HUDSON HIGHLAND GROUP, INC.

(Exact Name of Registrant As Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of

**59-3547281**  
(I.R.S. Employer

Incorporation or Organization)

Identification Number)

**622 Third Avenue, New York, New York 10017**

(Address of Principal Executive Offices)

**(212) 351-7300**

(Registrant's telephone number, including area code)

---

**Securities Registered Pursuant to Section 12(b) of the Act: None.**

**Securities Registered Pursuant to Section 12(g) of the Act: Common Stock, \$.001 par value per share**

**Preferred Share Purchase Rights**

---

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 15 (d) of the Securities 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 past 90 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. Yes  No

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 Exchange Act). (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$325,648,000 as of June 30, 2005.

The number of shares of Common Stock, \$.001 par value, outstanding as of March 1, 2006 was 24,385,000.

---

**Table of Contents**

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference into Part III.

**Table of Contents**

|   | <b>Page</b> |
|---|-------------|
| <b><u>PART I</u></b>  | 3           |
| ITEM 1. <u>BUSINESS</u>   | 3           |
| ITEM 1A. <u>RISK FACTORS</u>  | 5           |
| ITEM 1B. <u>UNRESOLVED STAFF COMMENTS</u>   | 11          |
| ITEM 2. <u>PROPERTIES</u>   | 11          |
| ITEM 3. <u>LEGAL PROCEEDINGS</u>  | 11          |
| ITEM 4. <u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>  | 11          |
| <u>EXECUTIVE OFFICERS OF THE REGISTRANT</u>   | 12          |
| <b><u>PART II</u></b>   | 14          |
| ITEM 5. <u>MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u> | 14          |
| ITEM 6. <u>SELECTED FINANCIAL DATA</u>  | 15          |
| ITEM 7. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                        | 16          |
| ITEM 7A. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>  | 31          |
| ITEM 8. <u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>  | 32          |
| ITEM 9. <u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>                         | 66          |
| ITEM 9A. <u>CONTROLS AND PROCEDURES</u>   | 66          |
| ITEM 9B. <u>OTHER INFORMATION</u>   | 67          |
| <b><u>PART III</u></b>  | 68          |
| ITEM 10. <u>DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT</u>  | 68          |
| ITEM 11. <u>EXECUTIVE COMPENSATION</u>  | 68          |
| ITEM 12. <u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>              | 68          |
| ITEM 13. <u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>  | 69          |
| ITEM 14. <u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>  | 69          |
| <b><u>PART IV</u></b>   | 69          |
| ITEM 15. <u>EXHIBITS, FINANCIAL STATEMENTS SCHEDULES</u>  | 69          |
| <u>SIGNATURES</u>   | 72          |
| <u>EXHIBIT INDEX</u>  | 73          |

---

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS**

Hudson Highland Group, Inc. ( the Company or we , us and our ) is one of the world s largest specialized professional staffing, retained executive search and talent management solutions providers. The Company provides professional staffing services on a permanent, contract and temporary basis, as well as executive search and a range of talent management services to businesses operating in many industries. We help our clients in recruiting employees for positions ranging from mid-level or professional candidates to senior executives. The Company reassessed its reportable segments in the fourth quarter of 2005 and prior period results are presented in conformity with the 2005 presentation. The Company is organized into four reportable segments, the three Hudson regional businesses of Hudson Americas, Hudson Europe and Hudson Asia Pacific, and Highland Partners ( Highland ). These groups constituted approximately 21%, 38%, 30% and 11% of the Company s gross margin, respectively, for the year ended December 31, 2005.

*Hudson Regional Businesses.* Hudson s three regions provide temporary and contract personnel and permanent recruitment services to a wide range of clients. With respect to temporary and contract personnel, Hudson focuses on providing candidates with specialized functional skills and competencies, such as accounting and finance, legal and information technology. The length of a temporary assignment can vary, but engagements at the professional level tend to be longer than those in the general clerical or industrial sectors. With respect to permanent recruitment, Hudson focuses on mid-level professionals typically earning between \$50,000 and \$150,000 annually and possessing the professional skills and/or profile required by clients. Hudson provides permanent recruitment services on both a retained and contingent basis. In larger markets, Hudson s sales strategy focuses on both clients operating in particular industry sectors, such as financial services, health care, or technology, and candidates possessing particular professional skills, such as accounting and finance, information technology, legal and human resources. Hudson uses both traditional and interactive methods to select potential candidates for its clients, employing a suite of products that assesses talent and help predict whether a candidate will be successful in a given role.

All of the Hudson regional businesses also provide organizational effectiveness and development services through their Talent Management Solutions units. These services encompass candidate assessment, competency modeling, leadership development, performance management, and career transition. These services enable Hudson to offer clients a comprehensive set of management services, across the entire employment life cycle, from attracting, assessing and selecting best-fit employees to engaging and developing those individuals to help build a high-performance organization. Through the Hudson Center for High Performance (the Center for High Performance ), the Company also offers leadership solutions designed to assist senior management in enhancing the operating performance of their organizations.

Hudson Americas operates from 48 offices in two countries, with 96% of its 2005 gross margin generated in the United States. Hudson Europe operates from 48 offices in 17 countries, with 58% of its 2005 gross margin coming from the United Kingdom operations. Hudson Asia Pacific operates from 25 offices in 6 countries, with 65% of its 2005 gross margin stemming from Australia.

*Highland.* Highland, an executive search boutique with global reach, offers a comprehensive range of executive search services on a retained basis aimed exclusively at recruiting senior level executives. Highland also has a specialized practice that assists clients desiring to enhance their boards of directors.

Highland approaches the market through industry sectors, such as financial services, life sciences, retail and consumer products and technology. This industry sector sales approach is designed to enable Highland to better understand the strategic management issues and market conditions faced by clients within their specific business segments. Highland also recruits candidates through functional specialist groups, including those focused on boards of directors and senior officers in the finance, information technology, human resources and legal professions.

## **Table of Contents**

Highland operates in 14 practice offices in four countries. For the year ended December 31, 2005, approximately 75% of gross margin in the Highland business was derived in North America.

Corporate expenses are reported separately from the four reportable segments and consist primarily of expenses for compensation, marketing programs, rent and professional consulting.

The Company was historically the combination of 67 acquisitions (the Constituent Companies) made between 1999 and 2002, which became the eResourcing and Executive Search divisions (HH Group) of Monster Worldwide, Inc. (Monster), formerly TMP Worldwide, Inc. Some of the Company's constituent businesses have operated for more than 20 years. On March 31, 2003 (the Distribution Date), Monster distributed all of the outstanding shares of the newly named HH Group to its stockholders of record on March 14, 2003 on a basis of one share of HH Group common stock for each thirteen and one-third shares of Monster common stock so held (the Distribution). Since the Distribution, the Company has operated as an independent publicly held company, adding one mid-sized and three smaller acquisitions, and reorganizing a number of smaller business units after determining that those businesses were not viable profit centers.

## **SALES AND MARKETING**

Each of Hudson's regional business units maintains a sales force that is aligned along functional practice areas or industry sector groups as appropriate for the market. At the same time, these business development specialists receive incentives for cross-selling services with other practices and business units as the client need arises. In addition, each region has a designated international sales liaison who coordinates new business efforts with other geographies as opportunities arise for global recruitment and/or talent management needs from a client or prospect. Responsibility for sales and business development within Highland Partners rests with the senior executives of the division who possess senior-level relationships with clients and can leverage those relationships into new executive search assignments.

The company's global marketing and communications function is responsible for brand and marketing strategy, channel programs, public relations and corporate/employee communications. This team closely coordinates with the operational leadership and regional/practice/business unit marketing teams to support sales and build a strong brand reputation both in the market and within the organization.

We use three principal channels for marketing our services and promoting our brand: (1) in the United Kingdom, Australia, New Zealand, and other countries where it is an accepted practice, we use client paid advertising for vacant positions; (2) public relations to promote original research on business management and human capital issues of particular relevance to senior business managers; and (3) the Internet, both for promoting the Company's services to clients and attracting, assisting and managing candidates.

## **CLIENTS**

The Company's clients include small to large-sized corporations and government agencies. No one client accounted for more than 5% of total annual revenue in 2005. At December 31, 2005, there were approximately 1,200 Hudson Americas clients, 5,500 Hudson Europe clients, 4,900 Hudson Asia Pacific clients and over 500 Highland clients.

## **COMPETITION**

The markets for the Company's services and products are highly competitive. There are few barriers to entry, so new entrants occur frequently, resulting in a great deal of fragmentation. Companies in this industry compete on price, new capabilities and technologies, client attraction methods, and speed of completing assignments.

## **Table of Contents**

### **EMPLOYEES**

The Company employs approximately 3,800 people worldwide. In most jurisdictions our employees are not represented by a labor union or a collective bargaining agreement. The Company regards the relationships with its employees as satisfactory.

### **SEGMENT AND GEOGRAPHIC DATA**

Financial information concerning the Company's reportable segments and geographic areas of operation is included in Note 16 in the Notes to Consolidated Financial Statements contained in Item 8 of this Form 10-K.

### **AVAILABLE INFORMATION**

We maintain a web site with the address *www.hhgroup.com*. We are not including the information contained on our web site as part of, or incorporating it by reference into, this report. Through our web site, we make available free of charge (other than an investor's own Internet access charges) our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports in a timely manner after we provide them to the Securities and Exchange Commission.

### **ITEM 1A. RISK FACTORS**

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected.

#### **Since our spin-off in 2003, we have had a history of negative cash flows and operating losses that may continue for at least the next year.**

We have experienced negative cash flows and we have shown operating and net losses in the past. In 2005, we became modestly profitable. For the year ended December 31, 2005, we used cash in operating activities of \$26.3 million and we recorded net income attributable to common stockholders of \$5.3 million. We expect to continue to experience negative cash flows from operating activities for at least the next year. If our revenue grows more slowly than we anticipate or if operating expenses exceed our expectations, we may not be profitable in the next year.

#### **Our revenues can vary because our clients can terminate their relationship with us at any time with limited or no penalty.**

We provide executive search and mid-market professional staffing services on a temporary assignment-by-assignment basis, which clients can generally terminate at any time or reduce their level of use when compared to prior periods. Our executive search and professional staffing business is also significantly affected by our clients hiring needs and their views of their future prospects. Clients may, on very short notice, reduce or postpone their recruiting assignments with us and therefore, affect demand for our services.

#### **Our operations will be affected by global economic fluctuations.**

Demand for our services may fluctuate with changes in economic conditions, especially those resulting in slower or reduced employment growth. Because we operate from many small offices with fixed overhead, we have only limited flexibility to reduce expenses during economic downturns. Further, we may face increased pricing pressures during these times. For example, during 2001 and 2002, employers across the United States

---

**Table of Contents**

reduced their overall workforce to reflect the slowing demand for their products and services. In turn, our revenue was significantly reduced in the United States. Economic conditions could continue in 2006, which could have a material adverse effect on our business, financial condition and operating results.

**Our credit facility restricts our operating flexibility.**

We have a \$75.0 million senior secured credit facility. As of December 31, 2005, we had outstanding borrowings of \$30.1 million and letters of credit issued and outstanding of \$15.5 million under the credit facility. Available credit for use under the credit facility as of December 31, 2005 was \$29.4 million. Our ability to borrow under the credit facility is tied to a borrowing base of our eligible accounts receivable. If the amount or quality of our accounts receivable deteriorates, our ability to borrow under the credit facility will be directly affected. In addition, our credit facility requires that we satisfy certain financial covenants, including complying with targeted levels of adjusted EBITDA. As a result, we cannot assure you that we will be able to borrow under our credit agreement if we need money to fund working capital or other needs. In addition, our credit facility contains various restrictions and covenants that restrict our operating flexibility including:

prohibitions on payments of dividends and repurchases of stock;

restrictions on our ability to make additional borrowings, or to consolidate, merge or otherwise fundamentally change the ownership of the Company; and

limitations on investments, dispositions of assets and guarantees of indebtedness.

These restrictions and covenants could have important consequences for investors, including the need to use a portion of our cash flow from operations for debt service rather than for our operations, an inability to incur additional debt financing for future working capital or capital expenditures, a lesser ability to take advantage of significant business opportunities, such as acquisition opportunities, or to react to market conditions; lesser ability to sell assets, grant or incur liens on our assets, or engage in mergers or consolidations.

Our ability to comply with these financial requirements and other restrictions may be affected by events outside our control, in particular macroeconomic events. Our inability to comply with them could result in a default under our credit facility or other debt instruments. If a default occurs under our credit facility, the lenders under this facility could elect to declare all of the outstanding borrowings, as well as accrued interest and fees, to be due and payable and require us to apply all of our available cash to repay those borrowings. In addition, a default may result in higher rates of interest and the inability to obtain additional borrowings. Further, debt incurred under our credit facility bears interest at variable rates. Any increase in interest expense could reduce the funds available for operations.

**We face risks relating to our foreign operations.**

We conduct operations in over 20 foreign countries. For the years ended December 31, 2005, 2004 and 2003, approximately 66%, 70% and 71%, respectively, of our revenue was earned outside of the United States. The financial results of our company could be materially affected by a number of factors particular to international operations. These include but are not limited to difficulties in staffing and managing foreign operations; operational issues such as longer customer payment cycles and greater difficulties in collecting accounts receivable;

changes in tax laws or other regulatory requirements;

issues relating to uncertainties of laws and enforcement relating to the regulation and protection of intellectual property; and currency fluctuation. If we are forced to discontinue any of our international operations, we could incur material costs to close down such operations.

Regarding the foreign currency risk inherent in foreign operations, the results of our local operations are reported in the applicable foreign currencies and then translated into U.S. dollars at the applicable foreign





## **Table of Contents**

currency exchange rates for inclusion in our financial statements. In addition, we generally pay operating expenses in the corresponding local currency. We had no hedging or similar foreign currency contracts outstanding at December 31, 2005. Because of devaluations and fluctuations in currency exchange rates or the imposition of limitations on conversion of foreign currencies into U.S. dollars, we are subject to currency translation exposure on the revenue and income of our operations in addition to economic exposure. This risk could have a material adverse effect on our business, financial condition and operating results.

### **We face risks associated with acquisitions.**

From time to time, we make acquisitions. The success of these acquisitions is dependent upon our ability to integrate acquired personnel, operations, products and technologies into our organization effectively; and our ability to retain and motivate key personnel and to retain the clients of acquired firms. If we are not successful upon making an acquisition in the aspects of its integration into our operations, our financial results may be materially adversely affected.

### **We rely on our information systems, and if we lose that technology or fail to further develop our technology, our business could be harmed.**

Our success depends in large part upon our ability to store, retrieve, process and manage substantial amounts of information, including our client and candidate databases. To achieve our strategic objectives and to remain competitive, we must continue to develop and enhance our information systems. This may require the acquisition of equipment and software and the development, either internally or through independent consultants, of new proprietary software. Our inability to design, develop, implement and utilize, in a cost-effective manner, information systems that provide the capabilities necessary for us to compete effectively, or any interruption or loss of our information processing capabilities, for any reason, could harm our business, results of operations or financial condition.

### **Our markets are highly competitive.**

The markets for our services are highly competitive and those markets are characterized by pressures to reduce prices, incorporate new capabilities and technologies, accelerate job completion schedules and attract and retain highly skilled professionals who possess the skills and experience necessary to fulfill our clients' employee search needs.

Furthermore, we face competition from a number of sources. These sources include other executive search firms and professional search, staffing and consulting firms. Several of our competitors have greater financial and marketing resources than we do.

Due to competition, we may experience reduced margins on our products and services, as well as loss of market share and our customers. If we are not able to compete effectively with current or future competitors as a result of these and other factors, our business, financial condition and results of operations could be materially adversely affected.

We have no significant proprietary technology that would preclude or inhibit competitors from entering the mid-market professional staffing and temporary contracting and executive search markets. We cannot assure you that existing or future competitors will not develop or offer services and products that provide significant performance, price, creative or other advantages over our services. In addition, we believe that with continuing development and increased availability of information technology, the industries in which we compete may attract new competitors. Specifically, the advent and increased use of the Internet may attract technology-oriented companies to the executive search industry. We cannot assure you that we will be able to continue to compete effectively against existing or future competitors. Any of these events could have a material adverse effect on our business and operating results.

## **Table of Contents**

### **Our operating results fluctuate from quarter to quarter and therefore quarterly results cannot be used to predict future periods' results.**

Our operating results fluctuate quarter to quarter in the past primarily due to the vacation periods of the first quarter in the Australasia region and the third quarter in the US and Europe regions. Demands for our services are typically lower during vacation periods.

### **Our employees may depart with existing executive search clients.**

The success of our executive search business depends upon the ability of employees to develop and maintain strong, long-term relationships with clients. Usually, one or two employees have primary responsibility for a client relationship. When an employee leaves an executive search firm and joins another, clients that have established relationships with the departing employee may move their business to the employee's new employer. The loss of one or more clients is more likely to occur if the departing employee enjoys widespread name recognition or has developed a reputation as a specialist in executing searches in a specific industry or management function. Historically, we have not experienced a significant number of departures of executive search partners. However, a failure to retain our most effective executive search partners or maintain the quality of service to which our clients are accustomed could have a material adverse effect on our business, financial condition and operating results. Also, the ability of a departing executive search partner to move business to his or her new employer could have a material adverse effect on our business, financial condition and operating results.

Competition for highly skilled professionals is intense, and we compete with professional staffing and executive search agencies for qualified professionals. We and many of our competitors have experienced turnover of qualified professionals. We believe that we have been able to attract and retain highly qualified, effective professionals as a result of our reputation and our performance-based compensation system. These professionals have the potential to earn substantial bonuses based on the amount of revenue they generate by obtaining or executing executive search and permanent placement assignments or assisting other professionals to obtain or complete executive search and permanent placement assignments.

Bonuses and commissions represent a significant proportion of these professionals' total compensation. Any diminution of our reputation could impair our ability to retain existing or attract additional highly skilled professionals. Any inability to attract and retain highly skilled professionals could have a material adverse effect on our executive search business, financial condition and operating results.

### **We face restrictions imposed by blocking arrangements in Highland Partners.**

Either by agreement with clients or for marketing or client relationship purposes, executive search firms frequently refrain, for a specified period of time, from recruiting certain employees of a client, and possibly other entities affiliated with such client, when conducting executive searches on behalf of other clients. This is known as a "blocking" or "off-limits" arrangement. Blocking arrangements generally remain in effect for one or two years following completion of an assignment. The actual duration and scope of any blocking arrangement, including whether it covers all operations of a client and its affiliates or only certain divisions of a client, generally depends on such factors as:

the length of the client relationship;

the frequency with which the executive search firm has been engaged to perform executive searches for the client; and

the number of assignments the executive search firm has generated or expects to generate from the client.

Some of our executive search clients are recognized as industry leaders and/or employ a significant number of qualified executives who are potential candidates for other companies in that client's industry. Blocking

## **Table of Contents**

arrangements with a client of this nature, or the awareness by a client's competitors of such an arrangement, may make it difficult for us to obtain executive search assignments from, or to fulfill executive search assignments for, competitors while employees of that client may not be solicited. As our client base grows, particularly in our targeted business sectors, blocking arrangements increasingly may impede our growth or ability to attract and serve new clients. This could have an adverse effect on our business, results of operations and financial condition.

**We may be exposed to employment-related claims, legal liability and costs from both clients and employers that could adversely affect our business, financial condition and results of operations, and our insurance coverage may not cover all of our potential liability.**

We are in the business of employing people and placing them in the workplaces of other businesses. Risks relating to these activities include:

claims of misconduct or negligence on the part of our employees;

claims by our employees of discrimination or harassment directed at them, including claims relating to action of our clients;

claims related to the employment of illegal aliens or unlicensed personnel;

claims for payment of workers' compensation claims and other similar claims;

claims for violations of wage and hour requirements;

claims for retroactive entitlement to employee benefits;

claims of errors and omissions of our temporary employees, particularly in the case of professionals;

claims by taxing authorities related to our employment of independent contractors and the risk that such contractors could be considered employees for tax purposes;

claims related to our non-compliance with data protection laws which require the consent of a candidate to transfer resumes and other data; and

claims by our clients relating to our employees' misuse of client proprietary information, misappropriation of funds, other criminal activity or torts or other similar claims.

We are exposed to potential claims with respect to the recruitment process. A client could assert a claim for matters such as breach of a blocking arrangement or recommending a candidate who subsequently proves to be unsuitable for the position filled. Similarly, a client could assert a claim for deceptive trade practices on the grounds that we failed to disclose certain referral information about the candidate or misrepresented material information about the candidate. Further, the current employer of a candidate whom we place could file a claim against us alleging interference with an employment contract. In addition, a candidate could assert an action against us for failure to maintain the confidentiality of the candidate's employment search or for alleged discrimination or other violations of employment law by one of our clients.

We may incur fines and other losses or negative publicity with respect to these problems. In addition, some or all of these claims may give rise to litigation, which could be time-consuming to our management team, costly and could have a negative impact on our business. In some cases, we have agreed to indemnify our clients against some or all of these types of liabilities. We cannot assure you that we will not experience these

## Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

problems in the future, that our insurance will cover all claims or that our insurance coverage will continue to be available at economically feasible rates.

### **We depend on our key management personnel.**

Our continued success will depend to a significant extent on our senior management, including Jon F. Chait, our Chairman and CEO. The loss of the services of Mr. Chait or one or more key employees could have a

## **Table of Contents**

material adverse effect on our business, financial condition and operating results. In addition, if one or more key employees join a competitor or form a competing company, the resulting loss of existing or potential clients could have a material adverse effect on our business, financial condition and operating results.

### **There may be volatility in our stock price.**

The market price for our common stock has fluctuated in the past and could fluctuate substantially in the future. Factors such as the announcement of variations in our quarterly financial results or expected financial results could cause the market price of our common stock to fluctuate significantly. Further, due to the volatility of the stock market generally, the price of our common stock could fluctuate for reasons unrelated to our operating performance.

### **Government regulations may result in the prohibition, regulation or restriction of certain types of employment services we offer or in the imposition of additional licensing or tax requirements that may reduce our future earnings.**

In many jurisdictions in which we operate, the temporary staffing industry is heavily regulated. For example, governmental regulations can restrict the length of contracts of temporary employees and the industries in which temporary employees may be used. In some countries, special taxes, fees or costs are imposed in connection with the use of temporary workers. For example, temporary workers in France are entitled to a 10% allowance for the precarious nature of employment, which is eliminated if a full-time position is offered to them within three days. The countries in which we operate may:

create additional regulations that prohibit or restrict the types of employment services that we currently provide;

impose new or additional benefit requirements;

require us to obtain additional licensing to provide staffing services; or

increase taxes, such as sales or value-added taxes, payable by the providers of staffing services.

Any future regulations that make it more difficult or expensive for us to continue to provide our staffing services may have a material adverse effect on our financial condition, results of operations and liquidity.

### **Provisions in our organizational documents and Delaware law will make it more difficult for someone to acquire control of us.**

Our certificate of incorporation and by-laws and the Delaware General Corporation Law contain several provisions that make more difficult an acquisition of control of us in a transaction not approved by our board of directors, including transactions in which stockholders might otherwise receive a premium for their shares over then current prices, and that may limit the ability of stockholders to approve transactions that they may deem to be in their best interests. Our certificate of incorporation and by-laws include provisions:

dividing our board of directors into three classes to be elected on a staggered basis, one class each year;

authorizing our board of directors to issue shares of our preferred stock in one or more series without further authorization of our stockholders;

requiring that stockholders provide advance notice of any stockholder nomination of directors or any proposal of new business to be considered at any meeting of stockholders;

permitting removal of directors only for cause by a super-majority vote;

providing that vacancies on our board of directors will be filled by the remaining directors then in office;

requiring that a super-majority vote be obtained to amend or repeal specified provisions or our certificate of incorporation or by-laws;  
and

## **Table of Contents**

eliminating the right of stockholders to call a special meeting of stockholders or take action by written consent without a meeting of stockholders.

In addition, Section 203 of the Delaware General Corporation Law generally provides that a corporation may not engage in any business combination with any interested stockholder during the three-year period following the time that the stockholder becomes an interested stockholder, unless a majority of the directors then in office approve either the business combination or the transaction that results in the stockholder becoming an interested stockholder or specified stockholder approval requirements are met.

In addition, our Board of Directors declared a dividend of one preferred share purchase right (a Right ) for each outstanding share of common stock of the Company payable upon the close of business on February 28, 2005 to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$.001 par value ( Preferred Shares ), of the Company at a price of \$60 per one one-hundredth of a Preferred Share, subject to adjustment. These Rights may make the cost of acquiring the Company more expensive and, therefore, make an acquisition more difficult.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 2. PROPERTIES**

All of the Company's operating offices are located in leased premises. Our principal office is currently located at 622 Third Avenue, New York, New York, where we occupy space under a lease with Monster expiring in July 2015.

In the United States, Hudson Americas operates from 39 leased locations with space of approximately 197,000 square feet, Highland operates from six leased locations with space of approximately 45,000 square feet and there are seven leased locations with space of approximately 93,000 square feet, which are shared between the Hudson North America, Highland and corporate functions.

Outside the U.S., in the 20 additional countries in which the Company is located, Hudson Europe is the lessee of 42 locations with approximately 381,000 square feet, Hudson Asia Pacific is the lessee of 25 locations with approximately 296,000 square feet, Hudson Americas is a lessee of one location with approximately 10,000 square feet, Highland leases two locations with approximately 19,000 square feet, and Hudson and Highland share approximately 7,000 square feet in one location. All leased space is considered to be adequate for the operation of its business, and no difficulties are foreseen in meeting any future space requirements. The Company owns three vacant buildings in India, with approximately 6,700 square feet, which the Company is currently offering for sale.

### **ITEM 3. LEGAL PROCEEDINGS**

The Company is involved in various legal proceedings that are incidental to the conduct of its business. The Company is not involved in any pending or threatened legal proceedings that it believes could reasonably be expected to have a material adverse effect on its financial condition or results of operations.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matter was submitted to a vote of the Company's security holders during the fourth quarter of the fiscal year covered in this report.

**Table of Contents****EXECUTIVE OFFICERS OF THE REGISTRANT**

The following table sets forth certain information, as of February 24, 2006, regarding the executive officers of Hudson Highland Group, Inc.:

| Name                 | Age | Title   |
|----------------------|-----|---|
| Jon F. Chait         | 55  | Chairman and Chief Executive Officer  |
| Mary Jane Raymond    | 45  | Executive Vice President and Chief Financial Officer                                      |
| Margaretta R. Noonan | 48  | Executive Vice President and Chief Administrative Officer                                 |
| Donald E. Bielinski  | 56  | Senior Vice President, Chairman Asia Pacific Region and Chairman Hudson Talent Management |
| Richard S. Gray      | 49  | Senior Vice President, Marketing and Communications                                       |
| Richard A. Harris    | 47  | Senior Vice President and Chief Information Officer                                       |
| Neil J. Funk         | 54  | Vice President, Internal Audit  |
| Elaine A. Kloss      | 48  | Vice President Finance and Treasurer  |
| Ralph L. O Hara      | 61  | Vice President and Global Controller  |
| Latham Williams      | 53  | Vice President, Legal Affairs and Administration, Corporate Secretary                     |

The following biographies describe the business experience of our executive officers:

Jon F. Chait has served as Chairman and Chief Executive Officer since the Company was spun off from Monster in March 2003. He joined Monster in October 2002 expressly in contemplation of the spin-off. Prior to joining the Company, Mr. Chait was the Chairman of Spring Group, PLC, a provider of workforce management solutions, from May 2000 through June 2002 and Chief Executive Officer from May 2000 to March 2002. From 1998 through 2000, Mr. Chait founded and acted as Chairman and Chief Executive Officer of Magenta Limited, a developer of web-enabled human resource solutions, which was subsequently sold to Spring Group, PLC. Mr. Chait served as the Managing Director International Operations of Manpower Inc. from 1995 to July 1998, Chief Financial Officer from August 1993 to 1998 and Executive Vice President, Secretary and Director from 1991 to 1998, and Executive Vice President from September 1989 to July 1998 of Manpower International Inc., a provider of temporary employment services. Mr. Chait is also a director of the Marshall and Ilsley Corporation, a bank holding company, and Krueger International Inc., a manufacturer of office furniture.

Mary Jane Raymond has served as the Executive Vice President and Chief Financial Officer of Hudson Highland Group since December 1, 2005. Prior to that Ms. Raymond was the Chief Risk Officer of The Dun & Bradstreet Corporation during 2005. From 2002 to 2005, Ms. Raymond served as the Vice President and Corporate Controller of the Dun & Bradstreet Corporation. Ms. Raymond served as the Merger Integration Vice President of Lucent Technologies, Inc. from 1998 to 2002 and as Financial Vice President in International from 1997 to 1998. From 1992 to 1997, Ms. Raymond served in various positions with Cummins, Inc.

Margaretta R. Noonan has served as Executive Vice President and Chief Administrative Officer since February 2, 2005. Prior to that Ms. Noonan served as Executive Vice President, Human Resources since she joined the Company in January 2003. Prior to joining HH Group, Ms. Noonan served as Senior Vice President, Global Human Resources and corporate officer of Monster Worldwide, Inc. Prior to joining Monster in 1998, Ms. Noonan was Vice President, Human Resources Stores, for the Lord & Taylor division of May Department Stores Company, a large retail department store, from February 1997 to May 1998 and was Vice President, Human Resources, of Kohl's Corporation, a large retail department store, from November 1992 to February 1997.

Donald E. Bielinski has served as Senior Vice President, Chairman Asia Pacific Region and Chairman Hudson Talent Management since December 31, 2005. Prior to that, Mr. Bielinski served as President, Strategic Business Services Group, since joining the Company in July 2004. Prior to joining the Company, Mr. Bielinski was President and Chief Executive Officer of Exostar, a Washington, D.C. based technology services firm from January 2002 to June 2004. Prior to that, Mr. Bielinski served at W.W. Grainger, Inc., a provider of maintenance,



**Table of Contents**

repair, and operating supplies, services, and related information, as Group President, from 1997 until June of 2001, after serving as Senior Vice President, Marketing and Sales and as Senior Vice President, Organization and Planning.

Richard S. Gray has served as Senior Vice President, Marketing and Communications since February 2, 2005. Prior to that, Mr. Gray served as Vice President, Marketing and Communications since joining the Company in May 2003. Prior to joining the Company, Mr. Gray was Senior Vice President for Ogilvy Public Relations Worldwide, a large public relations firm, in Chicago, Illinois from September 2002 until May 2003. Before joining Ogilvy Public Relations Worldwide, Mr. Gray was a Vice President, Marketing and Communications for Lante Corporation, an internet consulting boutique, in Chicago, Illinois from November 1998 until November 2001.

Richard A. Harris has served as Senior Vice President and Chief Information Officer since joining the Company in January 2003. Prior to that, Mr. Harris served as the Chief Information Officer of Spring Group, PLC, a U.K. based human capital management company, from March 2001 to December 2002. Prior to joining Spring Group, PLC, Mr. Harris was the interim Chief Information Officer at TRS Staffing Services, a U.K. subsidiary of Fluor Corporation specializing in the technical staffing business, from 1999 to 2000. Mr. Harris also served as Chief Information Officer between 1994 and 1998 at TAC Worldwide, an information technologies staffing company.

Neil J. Funk has served as Vice President, Internal Audit since joining the Company in August 2003. Prior to joining the Company, Mr. Funk was a Senior Manager at Deloitte & Touche LLP, a multi-national auditing and consulting firm, from September 2000 until July 2003. Before joining Deloitte & Touche, Mr. Funk was with Prudential Financial, Inc., a large insurance company, specializing in personal financial planning from March 2000 until August 2000. Before joining Prudential Financial, Inc., Mr. Funk was District Audit Manager for PRG-Schultz, Inc., a recovery audit company, based in Atlanta, Georgia from September 1997 until February 2000.

Elaine A. Kloss has served as Vice President, Finance and Treasurer since June 2005. Prior to joining Hudson Highland Group, Ms. Kloss was Vice President and Treasurer of NUI Utilities, Inc., a public company with natural gas distribution operations from January 2004 to January 2005. Prior to that, she served as treasury associate for Resources Global Professionals, Inc., an international professional services firm, from 2002 to 2004. Ms. Kloss served as Vice President and Treasurer with Ventiv Health, Inc., a diversified contract pharmaceutical sales company, from 1999 to 2001. Ms. Kloss also has held various treasury and financial positions at New York Life Insurance Company, Joseph E. Seagram & Sons, Inc., AT&T and the Board of Governors of the Federal Reserve System.

Ralph L. O Hara has served as Vice President and Global Controller since joining the Company in June of 2003. Prior to joining the Company, Mr. O Hara was Chief Financial Officer and Treasurer for The Domestic and Foreign Missionary Society, a major not-for-profit organization also known as the Episcopal Church of the United States, from 2001 until June of 2003. Before joining The Domestic and Foreign Missionary Society, Mr. O Hara was Controller for GATX Corporation, a specialized finance and leasing company, from 1986 until 2000.

Latham Williams has served as Vice President, Legal Affairs and Administration, Corporate Secretary since joining the Company in January 2003. Prior to joining the Company, Mr. Williams was a Partner, Leader Diversity Practice Group and Co-Leader Global Legal Practice in Monster's executive search division. Prior to joining Monster in 2001, Mr. Williams was an equity partner with the international law firm of Sidley Austin LLP from 1993 to 2000, specializing in health care joint ventures, mergers and acquisitions. Before joining Sidley Austin Brown and Wood, Mr. Williams was an equity partner in the Chicago-based law firm of Gardner, Carton & Douglas and was with the firm from 1981 to 1993.

Executive officers are elected by, and serve at the discretion of, the Board of Directors. There are no family relationships between any of our directors or executive officers.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****MARKET FOR COMMON STOCK**

The Company's common stock is listed for trading on the Nasdaq National Market under the symbol HHGP. On December 31, 2005, there were approximately 1,295 holders of record of the Company's common stock.

The following is a list by fiscal quarter of the market prices of the stock.

|                | Market Price |           |
|----------------|--------------|-----------|
|                | High         | Low       |
| <b>2005</b>    |              |           |
| Fourth quarter | \$ 28.32     | \$ 17.28  |
| Third quarter  | \$ 25.80     | \$ 15.36  |
| Second quarter | \$ 17.35     | \$ 13.21  |
| First quarter  | \$ 17.84     | \$ 13.10  |
| <b>2004</b>    |              |           |
| Fourth quarter | \$ 15.00     | \$ 13.065 |
| Third quarter  | \$ 15.89     | \$ 12.535 |
| Second quarter | \$ 16.205    | \$ 12.945 |
| First quarter  | \$ 14.13     | \$ 10.995 |

We have never declared or paid cash dividends on our common stock, and we currently do not intend to declare and pay cash dividends on our common stock. Any payment of cash dividends will depend upon our financial condition, capital requirements, earnings and other factors deemed relevant by our Board of Directors. In addition, the terms of our credit facility prohibit us from paying dividends and making other distributions.

**ISSUER PURCHASES OF EQUITY SECURITIES**

During the quarter ended December 31, 2005, the Company made no repurchases of its equity securities.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following table shows selected financial data of the Company and has been derived from, and should be read together with, the consolidated financial statements and corresponding notes and Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Items 7 and 8 of this Form 10-K. The Company's consolidated financial statements prior to the Distribution reflect the historical financial position, results of operations and cash flows of the HH Group businesses transferred to the Company from Monster as part of the Distribution. The selected financial information included herein for periods prior to the Distribution may not necessarily be indicative of the future performance of the Company as an independent company. The consolidated financial data as of and for the two years ended December 31, 2002 and 2001 are derived from HH Group audited financial statements.

|   | Year ended December 31, |              |              |              |              |
|---|-------------------------|--------------|--------------|--------------|--------------|
|   | 2005                    | 2004         | 2003         | 2002         | 2001         |
| (dollars in thousands, except per share data)                         |                         |              |              |              |              |
| <b>STATEMENT OF OPERATIONS:</b>                                       |                         |              |              |              |              |
| Revenue   | \$ 1,428,276            | \$ 1,256,354 | \$ 1,085,299 | \$ 1,065,439 | \$ 1,287,798 |
| Direct costs  | 891,345                 | 786,134      | 682,270      | 653,569      | 716,262      |
| Gross margin  | 536,931                 | 470,220      | 403,029      | 411,870      | 571,536      |
| Salaries and related, office and general, and marketing and promotion | 507,184                 | 469,214      | 463,108      | 431,615      | 523,273      |
| Business reorganization expenses                                      | 233                     | 3,361        | 26,823       | 73,543       |              |
| Merger and integration expenses (recoveries)                          | (70)                    | 736          | 2,663        | 5,373        | 43,177       |
| Goodwill impairment charge  |                         |              | 202,785      |              |              |
| EBITDA (loss) (a)   | 29,584                  | (3,091)      | (292,350)    | (98,661)     | 5,086        |
| Depreciation and amortization   | 18,412                  | 20,108       | 21,299       | 21,061       | 33,290       |
| Operating income (loss)   | \$ 11,172               | \$ (23,199)  | \$ (313,649) | \$ (119,722) | \$ (28,204)  |
| Income (loss) before accounting change                                | \$ 5,313                | \$ (26,775)  | \$ (328,812) | \$ (119,251) | \$ (34,195)  |
| Net income (loss)   | \$ 5,313                | \$ (26,775)  | \$ (328,812) | \$ (412,251) | \$ (34,195)  |
| Basic income (loss) per share before accounting change (b)            | \$ 0.24                 | \$ (1.38)    | \$ (19.58)   | \$ (7.14)    | \$ (2.08)    |
| Basic net income (loss) per share (b)                                 | \$ 0.24                 | \$ (1.38)    | \$ (19.58)   | \$ (24.69)   | \$ (2.08)    |
| Diluted income (loss) per share before accounting change (b)          | \$ 0.22                 | \$ (1.38)    | \$ (19.58)   | \$ (7.14)    | \$ (2.08)    |
| Diluted net income (loss) per share (b)                               | \$ 0.22                 | \$ (1.38)    | \$ (19.58)   | \$ (24.69)   | \$ (2.08)    |
| <b>OTHER FINANCIAL DATA:</b>  |                         |              |              |              |              |
| Net cash provided by (used in) operating activities                   | \$ (26,298)             | \$ (30,895)  | \$ (42,629)  | \$ (110,834) | \$ 11,416    |
| Net cash used in investing activities                                 | \$ (35,715)             | \$ (10,128)  | \$ (11,390)  | \$ (16,589)  | \$ (118,785) |
| Net cash provided by financing activities                             | \$ 75,857               | \$ 35,278    | \$ 49,465    | \$ 112,054   | \$ 103,115   |

|                                      | As of December 31, |            |            |            |            |
|--------------------------------------|--------------------|------------|------------|------------|------------|
|                                      | 2005               | 2004       | 2003       | 2002       | 2001       |
| <b>BALANCE SHEET DATA:</b>           |                    |            |            |            |            |
| Current assets                       | \$ 280,519         | \$ 232,833 | \$ 198,416 | \$ 215,916 | \$ 246,248 |
| Total assets                         | \$ 348,416         | \$ 281,378 | \$ 250,924 | \$ 467,104 | \$ 765,986 |
| Current liabilities                  | \$ 202,760         | \$ 182,794 | \$ 158,821 | \$ 133,714 | \$ 232,080 |
| Long-term debt, less current portion | \$ 478             | \$ 2,041   | \$ 302     | \$ 1,184   | \$ 2,917   |
| Total stockholders' equity           | \$ 133,097         | \$ 83,734  | \$ 69,361  | \$ 316,574 | \$ 522,680 |

(a) Non-GAAP earnings before interest, income taxes, other non-operating expense, and depreciation and amortization (EBITDA) are presented to provide additional information to investors about the Company's operations on a basis consistent with the measures which the Company uses to manage its operations and evaluate its performance. Management also uses this measurement to evaluate capital needs and working capital requirements. EBITDA should not be considered in isolation or as a substitute for operating income, cash flows from operating activities, and other income or cash flow statement data prepared in accordance with generally accepted accounting principles or as a measure of the Company's profitability or liquidity. Furthermore, EBITDA as presented above may not be comparable with similarly titled measures reported by other companies. See Note 16 to the Consolidated Financial Statements for further EBITDA segment and reconciliation information.

## Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

- (b) For basic and diluted loss per share amounts for the periods prior to the Company's spin-off from Monster on March 31, 2003, Monster's weighted average number of shares was multiplied by the distribution ratio of one share of HH Group common stock for every thirteen and one-third shares of Monster common stock. Basic loss per share is computed by dividing the Company's losses by the weighted average number of shares outstanding during the period. When the effects are not anti-dilutive, diluted earnings per share is computed by dividing the Company's net earnings by the weighted average number of shares outstanding and the impact of all dilutive potential common shares, primarily stock options. The dilutive impact of stock options is determined by applying the treasury stock method.

## **Table of Contents**

### **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

#### **Executive Overview**

##### ***Background***

We have operated as an independent publicly traded company since April 1, 2003 (the Distribution Date), when we were spun-off from Monster Worldwide, Inc. ( Monster ). At the Distribution Date, we were the combination of 67 acquisitions (the Constituent Companies) made between 1999 and 2002, which became the eResourcing and Executive Search divisions ( HH Group ) of Monster. Our businesses are specialized professional staffing, retained executive search and talent management solutions services, which operate in over 20 countries around the world, with our largest operations being in the U.S., the U.K. and Australia. We are organized into four reportable segments, the three Hudson regional businesses of Hudson Americas, Hudson Europe and Hudson Asia Pacific, and Highland Partners ( Highland ), which constituted approximately 21%, 38%, 30% and 11% of the Company's gross margin, respectively, for the year ended December 31, 2005. For the periods presented in this Form 10-K before the Distribution Date, these businesses were conducted by Monster through the Constituent Companies at Monster's historical cost. Our management's primary focus since the spin-off has been to move the Company to profitability which was achieved in 2005. The primary focus now is to improve profitability. All three Hudson regional businesses reported operating income in every quarter since the first quarter of 2004 and Highland reported operating income in all quarters of 2005.

##### **Strategic Actions**

With the focus of our management being to continue the Company's recent profitability, we are continuing with several initiatives in 2005 and 2006 to meet our long-term strategic goals.

Continue to focus on high-margin, high-growth service lines in professional service practices and sectors, and exit low margin operations.

Increase the portion of our revenues attributable to temporary contracting in higher margin specializations to offset the volatility inherent in permanent recruitment. On August 17, 2005, we completed the purchase of Balance Ervaring op Projectbasis B.V. ( Balance ), a leading professional temporary and contract staffing firm in the Netherlands, to advance this strategy in Europe.

To grow our revenue in the North American market.

Realign our expense structure and infrastructure costs in various markets including office relocations and closures, and management staff reductions, to better match our business mix and improve the potential profitability of those operations.

Continue to reposition our Highland business as a global boutique. The strategic direction that we are following with our Highland businesses is to become an executive search boutique with global capabilities, operating at the highest end of the executive search market with a limited number of highly experienced partners. In the second quarter of 2005, part of our Australian operation split off as an independent brand licensee.

To strengthen our capital structure, in July 2005, we issued 3,223,640 shares of our common stock in a registered public offering and received \$45 million in net proceeds from the issuance. We have used and plan to continue to use the proceeds to fund the growth of worldwide staffing operations, make acquisitions (such as the completed purchase of Balance) and for general corporate purposes. Also in June 2005, we increased the maximum borrowing level allowed under our credit agreement to \$75 million and extended the maturity date of the credit agreement to March 31, 2009.



## **Table of Contents**

### **Critical Accounting Policies and Items Affecting Comparability**

Financial reporting relies on consistent application of company accounting policies that are based on generally accepted accounting principles. Management considers the accounting policies discussed below to be critical to understand the Company's financial statements and often require management judgment and estimates regarding matters that are inherently uncertain.

#### ***Revenue Recognition***

Although the Company's revenue recognition policy involves a relatively low level of uncertainty, it does require judgment on complex matters that is subject to multiple sources of authoritative guidance.

*Hudson Regional businesses.* The Company recognizes revenue for temporary services at the time services are provided and revenue is recorded on a time and materials basis. Temporary contracting revenue is reported gross when the Company acts as principal in the transaction and is at risk for collection. Revenue that does not meet the criteria for gross revenue reporting is reported on a net basis. Revenue generated when the Company permanently places an individual with a client on a contingent basis is recorded at the time of acceptance of employment, net of an allowance for estimated fee reversals. Revenue generated when the Company permanently places an individual with a client on a retained basis is recorded ratably over the period services are rendered, net of an allowance for estimated fee reversals.

*Highland.* Substantially all professional fee revenue is derived from fees for professional services related to executive recruitment, consulting and related services performed on a retained basis. Fee revenue is generally one-third of the estimated first year compensation and reimbursed expenses, plus a percentage of the fee to cover indirect expenses. Fee revenue from executive recruitment is recognized when such services are earned. The Company generally bills clients in three monthly installments. Fees earned in excess of the initial contract amount are recognized at completion of the engagement. Reimbursed out-of-pocket expenses are included in revenue.

#### ***Accounts Receivable***

The Company's accounts receivable balances are composed of trade and unbilled receivables. The Company maintains an allowance for doubtful accounts and makes ongoing estimates as to the collectibility of the various receivables. If the Company determines that the allowance for doubtful accounts is not adequate to cover estimated losses, an expense to provide for doubtful accounts is recorded in selling, general and administrative expenses. If an account is determined to be uncollectible, it is written off against the allowance for doubtful accounts. Management's assessment and judgment are vital requirements in assessing the ultimate realization of these receivables, including the current credit-worthiness, financial stability and effect of market conditions on each customer.

#### ***Income Taxes***

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss and tax credit carry-forwards, and tax contingencies. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company records a valuation allowance against deferred tax assets to the extent that it is more likely than not that some portion or all of the deferred tax assets will not be realized. At December 31, 2005, the Company has a valuation allowance against substantially all of its deferred tax assets.

#### ***Contingencies***

The Company is subject to proceedings, lawsuits and other claims related to labor, service and other matters. The Company is required to assess the likelihood of any adverse judgments or outcomes to these matters

**Table of Contents**

as well as potential ranges of probable losses. The Company makes a determination of the amount of reserves required, if any, for these contingencies after careful analysis of each individual issue. The required reserves may change in the future due to new developments in each matter or changes in approach, such as a change in settlement strategy in dealing with these matters.

***Intangibles***

Intangibles represent acquisition costs in excess of the fair value of net tangible assets of businesses purchased and consist primarily of client lists, trademarks and goodwill. With the exception of goodwill, these costs are being amortized over periods ranging from three to five years on a straight-line basis or on an accelerated basis where appropriate. The Company evaluates its goodwill annually for impairment, or earlier if indicators of potential impairment exist.

***Business Reorganization and Merger and Integration Plans***

The Company has recorded significant charges and accruals in connection with its business reorganization, merger and integration plans. These reserves include estimates pertaining to employee separation costs and the settlement of contractual obligations resulting from its actions. Although the Company does not anticipate significant changes, the actual costs may differ from these estimates.



**Table of Contents****Results of Operations**

The following table sets forth the Company's revenue, gross margins, operating income (loss), net income (loss), temporary contracting revenue, direct costs of temporary contracting and temporary contracting gross margin for the years ended December 31, 2005, 2004 and 2003 (dollars in thousands). See Note 16 to the Consolidated Financial Statements for EBITDA segment and reconciliation information.

|   | For the Year ended December 31, |                     |                     |
|---|---------------------------------|---------------------|---------------------|
|   | 2005                            | 2004                | 2003                |
| <b>Revenue:</b>                               |                                 |                     |                     |
| Hudson Americas                               | \$ 446,949                      | \$ 334,765          | \$ 278,935          |
| Hudson Europe                                 | 481,623                         | 447,483             | 364,766             |
| Hudson Asia Pacific                           | 436,877                         | 412,427             | 377,555             |
| Highland                                      | 62,827                          | 61,679              | 64,043              |
| <b>Total</b>                                  | <b>\$ 1,428,276</b>             | <b>\$ 1,256,354</b> | <b>\$ 1,085,299</b> |
| <b>Gross margin:</b>                          |                                 |                     |                     |
| Hudson Americas                               | \$ 114,414                      | \$ 86,662           | \$ 65,220           |
| Hudson Europe                                 | 204,439                         | 182,069             | 154,632             |
| Hudson Asia Pacific                           | 158,345                         | 143,360             | 122,840             |
| Highland                                      | 59,733                          | 58,129              | 60,337              |
| <b>Total</b>                                  | <b>\$ 536,931</b>               | <b>\$ 470,220</b>   | <b>\$ 403,029</b>   |
| <b>Operating income (loss):</b>               |                                 |                     |                     |
| Hudson Americas                               | \$ 8,693                        | \$ (964)            | \$ (73,456)         |
| Hudson Europe                                 | 11,435                          | (4,476)             | (158,514)           |
| Hudson Asia Pacific                           | 24,054                          | 17,648              | (14,685)            |
| Highland                                      | 3,098                           | (1,874)             | (34,956)            |
| Corporate expenses                            | (36,108)                        | (33,533)            | (32,038)            |
| <b>Total</b>                                  | <b>\$ 11,172</b>                | <b>\$ (23,199)</b>  | <b>\$ (313,649)</b> |
| <b>Net income (loss)</b>                      | <b>\$ 5,313</b>                 | <b>\$ (26,775)</b>  | <b>\$ (328,812)</b> |
| <b>TEMPORARY CONTRACTING DATA (a):</b>        |                                 |                     |                     |
| <b>Temporary contracting revenue:</b>         |                                 |                     |                     |
| Hudson Americas                               | \$ 419,506                      | \$ 316,091          | \$ 267,473          |
| Hudson Europe                                 | 295,750                         | 265,279             | 217,874             |
| Hudson Asia Pacific                           | 318,918                         | 305,601             | 290,327             |
| <b>Total</b>                                  | <b>\$ 1,034,174</b>             | <b>\$ 886,971</b>   | <b>\$ 775,674</b>   |
| <b>Direct costs of temporary contracting:</b> |                                 |                     |                     |
| Hudson Americas                               | \$ 331,781                      | \$ 247,870          | \$ 213,996          |
| Hudson Europe                                 | 248,692                         | 227,887             | 184,843             |
| Hudson Asia Pacific                           | 267,399                         | 257,029             | 245,172             |
| <b>Total</b>                                  | <b>\$ 847,872</b>               | <b>\$ 732,786</b>   | <b>\$ 644,011</b>   |
| <b>Temporary contracting gross margin:</b>    |                                 |                     |                     |
| Hudson Americas                               | \$ 87,725                       | \$ 68,221           | \$ 53,477           |
| Hudson Europe                                 | 47,058                          | 37,392              | 33,031              |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|                                       |            |            |            |
|---------------------------------------|------------|------------|------------|
| Hudson Asia Pacific                   | 51,519     | 48,572     | 45,155     |
| Total                                 | \$ 186,302 | \$ 154,185 | \$ 131,663 |
| Gross margin as a percent of revenue: |            |            |            |
| Hudson Americas                       | 20.9%      | 21.6%      | 20.0%      |
| Hudson Europe                         | 15.9%      | 14.1%      | 15.2%      |
| Hudson Asia Pacific                   | 16.2%      | 15.9%      | 15.6%      |

- (a) Temporary contracting revenue is a component of Hudson revenue. Temporary contracting gross margin and gross margin as a percent of revenue are shown to provide additional information on the Company's ability to manage its cost structure and provide further comparability relative to the Company's peers. Temporary contracting gross margin is derived by deducting the direct costs of temporary contracting from temporary contracting revenue. The Company's calculation of gross margin may differ from those of other companies.

**Table of Contents****Constant Currency**

The Company defines the term "constant currency" to mean that financial data for a period are translated into U.S. Dollars using the same foreign currency exchange rates that were used to translate financial data for the previously reported period. Changes in revenue, direct costs, gross margin and selling, general and administrative expenses include the effect of changes in foreign currency exchange rates. Variance analysis usually describes period-to-period variances that are calculated using constant currency as a percentage. The Company's management reviews and analyzes business results in constant currency and believes these results better represent the Company's underlying business trends.

The Company believes that these calculations are a useful measure, indicating the actual change in operations. Earnings from subsidiaries are rarely repatriated to the United States, and there are not significant gains or losses on foreign currency transactions between subsidiaries. Therefore, changes in foreign currency exchange rates generally impact only reported earnings and not the Company's economic condition (dollars in thousands).

**The Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004**

|   | For the year ended December 31, |                                 |                      |                     |
|---|---------------------------------|---------------------------------|----------------------|---------------------|
|   | As reported                     | 2005<br>Currency<br>translation | Constant<br>currency | 2004<br>As reported |
| <b>Revenue:</b>                                 |                                 |                                 |                      |                     |
| Hudson Americas                                 | \$ 446,949                      | \$ 142                          | \$ 447,091           | \$ 334,765          |
| Hudson Europe                                   | 481,623                         | 1,616                           | 483,239              | 447,483             |
| Hudson Asia Pacific                             | 436,877                         | (17,177)                        | 419,700              | 412,427             |
| Highland revenue                                | 62,827                          | (627)                           | 62,200               | 61,679              |
| <b>Total</b>                                    | <b>\$ 1,428,276</b>             | <b>\$ (16,046)</b>              | <b>\$ 1,412,230</b>  | <b>\$ 1,256,354</b> |
| <b>Direct costs:</b>                            |                                 |                                 |                      |                     |
| Hudson Americas                                 | \$ 332,535                      | \$ 297                          | \$ 332,832           | \$ 248,103          |
| Hudson Europe                                   | 277,184                         | 1,324                           | 278,508              | 265,414             |
| Hudson Asia Pacific                             | 278,532                         | (11,379)                        | 267,153              | 269,067             |
| Highland  | 3,094                           | (358)                           | 2,736                | 3,550               |
| <b>Total</b>                                    | <b>\$ 891,345</b>               | <b>\$ (10,116)</b>              | <b>\$ 881,229</b>    | <b>\$ 786,134</b>   |
| <b>Gross margin:</b>                            |                                 |                                 |                      |                     |
| Hudson Americas                                 | \$ 114,414                      | \$ (155)                        | \$ 114,259           | \$ 86,662           |
| Hudson Europe                                   | 204,439                         | 292                             | 204,731              | 182,069             |
| Hudson Asia Pacific                             | 158,345                         | (5,798)                         | 152,547              | 143,360             |
| Highland  | 59,733                          | (269)                           | 59,464               | 58,129              |
| <b>Total</b>                                    | <b>\$ 536,931</b>               | <b>\$ (5,930)</b>               | <b>\$ 531,001</b>    | <b>\$ 470,220</b>   |
| <b>Selling, general and administrative (a):</b> |                                 |                                 |                      |                     |
| Hudson Americas                                 | \$ 105,246                      | \$ (164)                        | \$ 105,082           | \$ 86,688           |
| Hudson Europe                                   | 193,046                         | 549                             | 193,595              | 185,873             |
| Hudson Asia Pacific                             | 134,283                         | (4,543)                         | 129,740              | 126,165             |
| Highland  | 56,913                          | (222)                           | 56,691               | 57,063              |
| Corporate                                       | 36,108                          |                                 | 36,108               | 33,533              |
| <b>Total</b>                                    | <b>\$ 525,596</b>               | <b>\$ (4,380)</b>               | <b>\$ 521,216</b>    | <b>\$ 489,322</b>   |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

- (a) Selling, general and administrative expenses include the Consolidated Statements of Operations captions: salaries and related, office and general, marketing and promotion, and depreciation and amortization.

---

**Table of Contents*****Hudson Americas***

Hudson Americas revenue was \$446.9 million for the year ended December 31, 2005, up 33.5% from \$334.8 million for the same period of 2004. Revenues increased in both the temporary contracting services (+32.7%) and permanent placement services (+43.0%). The largest contributors to the revenue growth were the practice groups of Legal (+75%), Accounting & Finance (+83%), and Engineering, Aerospace & Defense (+92%). Accounting & Finance experienced a decline in work related to Sarbanes-Oxley in 2005, but these reductions were offset by increases in the risk management, internal audit and general financial solutions practices.

Hudson Americas direct costs for the year ended December 31, 2005 were \$332.5 million compared to \$248.1 million for 2004, an increase of 34.0%. The increase in the direct costs relates to the 32.7% increase in Hudson Americas temporary contracting revenue compared to 2004. On a constant currency basis, direct costs increased 34.2% for 2005 in comparison to 2004.

Hudson Americas gross margin for the year ended December 31, 2005 was \$114.4 million, higher by \$27.7 million, or 32.0%, from \$86.7 million reported for the year ended December 31, 2004. On a constant currency basis, gross margin increased by 31.8% for the year ended December 31, 2005 when compared to the year ended December 31, 2004. The largest contributors to the increase in gross margin were Legal (+53%), Accounting & Finance (+74%), Engineering, Aerospace & Defense (+94%), Management Search (+46%), and Energy, Operations & Scientific Resources (+21%) practice groups. Gross margin, as a percentage of revenue, was 25.6%, for 2005, a decrease from 25.9% for 2004, primarily as a result of a 0.7% decrease in the temporary contracting gross margin as a percent of temporary contracting revenue.

Hudson Americas selling, general and administrative costs were \$105.2 million for the year ended December 31, 2005, higher by 21.4% from \$86.7 million for the same period in 2004. Selling, general and administrative expenses were 23.5% and 25.8% as a percentage of revenue for the full years 2005 and 2004, respectively. The increase in selling, general and administrative costs was due to increases in sales and delivery compensation and commission expenses (\$12.7 million), provisions for doubtful accounts (\$3.4 million) and occupancy expenses (\$1.4 million).

Hudson Americas EBITDA was \$13.9 million for the year ended December 31, 2005, an increase of \$9.6 million compared to \$4.3 million for the comparable period of 2004. Hudson North America's 2005 EBITDA of \$17.5 million was \$7.7 million higher than the comparable period in 2004 showing a continuation of the improvements made in 2004 and the expansion of permanent placement and temporary contracting in the Legal (+73%), Accounting & Finance (+327%), Engineering, Aerospace & Defense (+531%) and Management Search (+359%) practice groups, as well as lower growth but profitable operations for the IT, Workforce Solutions and Energy, Operations & Scientific Resources practice groups. The Hudson Americas talent management business (Hudson Development) reduced its EBITDA loss to \$3.6 million in 2005 compared to \$5.4 million for the comparable period in 2004. In line with management's focus on sustainable profits, EBITDA as a percentage of revenue increased to 3.1% in 2005 from 1.3% for 2004.

Hudson Americas operating income was \$8.7 million for the year ended December 31, 2005, compared to a loss of \$1.0 million for the same period of 2004. Hudson Americas 2005 improvement in operating income was essentially due to the same factors as discussed with respect to EBITDA.

***Hudson Europe***

Hudson Europe's revenue was \$481.6 million for the year ended December 31, 2005, up 7.6% from \$447.5 million for the same period of 2004. On a constant currency basis, Hudson Europe's revenue increased approximately 8.0% comparing 2005 to 2004, with 3.3% of the increase attributable to revenue from the acquisition of Balance. The largest constant currency revenue increases were achieved from increased revenue in temporary contracting services (+12.2%) primarily from the U.K. and the Balance acquisition.

**Table of Contents**

Hudson Europe's direct costs for the year ended December 31, 2005 were \$277.2 million, an increase of \$11.8 million or 4.4% compared to \$265.4 million for the same period of 2004. On a constant currency basis, direct costs increased 4.9% for 2005 in comparison to 2004, of which 3.7% of the increase was from the inclusion of Balance since the date of acquisition.

Hudson Europe's gross margin for the year ended December 31, 2005 was \$204.4 million, higher by \$22.4 million, or 12.3%, from the comparable period in 2004. Gross margin, as a percentage of revenue, was 42.4%, for 2005, an increase from 40.7% for 2004, primarily due to the reduction in lower margin business. On a constant currency basis, gross margin increased by 12.4% for the year ended December 31, 2005 when compared to the same period in 2004. The largest constant currency increases in Hudson Europe's gross margin came from the U.K. (\$10.3 million) and the acquisition of Balance (\$5.1 million), which has been included in our results since its acquisition date in August 2005. On a constant currency basis, fourth quarter 2005 gross margin increased 7.9%, of which Balance contributed approximately 7% of the growth.

Hudson Europe's selling, general and administrative costs were \$193.0 million for the year ended December 31, 2005, higher by 3.9% from \$185.9 million for the same period in 2004. Selling, general and administrative expenses were 40.1% and 41.5% as a percentage of revenue for the full years 2005 and 2004, respectively. On a constant currency basis, the 2005 selling, general and administrative expenses increased by 4.2%, compared to 2004.

Hudson Europe's EBITDA was \$16.2 million for the year ended December 31, 2005, an increase of \$15.9 million compared to \$0.3 million for the same period in 2004. The largest EBITDA contributor in Hudson Europe was Hudson U.K., with additional contributions from Belgium and from improvements in France, the Netherlands and Spain. In line with management's focus on sustainable profits, EBITDA as a percentage of revenue increased to 3.4% in 2005 from less than 0.1% for 2004.

Hudson Europe's operating income was \$11.4 million for the year ended December 31, 2005, compared to a loss of \$4.5 million for the same period of 2004. Hudson Europe's 2005 improvement in operating results was essentially due to the same factors as discussed with respect to EBITDA.

***Hudson Asia Pacific***

Hudson Asia Pacific's revenue was \$436.9 million for year ended December 31, 2005, up 5.9% from \$412.4 million for the same period of 2004. On a constant currency basis, Hudson Asia Pacific's revenue increased approximately 1.8% comparing 2005 to 2004. The largest constant currency revenue increases were achieved in the Asian region from permanent placement services (+34.3%). However, Australia's 2005 revenue on a constant currency basis decreased by 0.8% compared to the same period in 2004. The lower revenue on a constant currency basis is predominantly due to a decrease in revenue from temporary placement services (-1.1%), offset by a modest increase in permanent placement revenue (+5.6%). Hudson Asia Pacific's revenue declined in the fourth quarter of 2005 by \$5.5 million on a constant currency basis compared to the same period in 2004, as a result of hiring freezes and slowing demand in Australia and New Zealand in the IT, Telecom and Financial Services sectors.

Hudson Asia Pacific's direct costs for the year ended December 31, 2005 were \$278.5 million, an increase of \$9.5 million or 3.5% compared to \$269.1 million for 2004. The increase in the direct costs in 2005 directly relates to the 4.4% increase in temporary contracting revenue compared to 2004. On a constant currency basis, direct costs decreased 0.7% for 2005 in comparison to 2004.

Hudson Asia Pacific's gross margin for the year ended December 31, 2005 was \$158.3 million, higher by \$15.0 million, or 10.5%, from \$143.4 million reported for the year ended December 31, 2004. Gross margin, as a percentage of revenue, was 36.2% for 2005, an increase from 34.8% for 2004, primarily due to higher gross margin from permanent placement and higher margin percentages from the temporary contracting and talent management businesses. On a constant currency basis, gross margin increased by 6.4% for the year ended December 31, 2005 when compared to the year ended December 31, 2004.

---

## **Table of Contents**

Hudson Asia Pacific's selling general and administrative costs were \$134.3 million for the year ended December 31, 2005, higher by 6.4% from \$126.2 million for the same period in 2004. Selling, general and administrative expenses were 30.7% and 30.6% as a percentage of revenue for the full years 2005 and 2004, respectively. On a constant currency basis, the 2005 selling, general and administrative expenses increased by 2.8%, compared to 2004.

Hudson Asia Pacific's EBITDA was \$30.6 million for the year ended December 31, 2005, an increase of 28.3% or \$6.8 million from \$23.8 million for the same period of 2004. The increase was primarily in Australia, New Zealand, Hong Kong and Singapore, with a decline in Japan. Hudson Asia Pacific's 2005 improvement in EBITDA occurred in the first nine months of 2005, as EBITDA decreased \$2.6 million in the fourth quarter of 2005, primarily in Australia, New Zealand and Japan, compared to the same period of 2004. These declines were primarily a result of hiring freezes and slowing demand in Australia and New Zealand in the IT, Telecom and Financial Services sectors.

Hudson Asia Pacific's operating income was \$24.1 million for the year ended December 31, 2005, an increase of 36.3% or \$6.4 million from \$17.6 million for the same period of 2004. Hudson Asia Pacific's 2005 improvement in operating results was primarily due to the same factors as discussed in EBITDA.

### ***Highland***

Highland's revenue of \$62.8 million for the year ended December 31, 2005 increased 1.9% from \$61.7 million from 2004. On a constant currency basis, Highland revenue increased 0.8% comparing 2005 results with 2004, reflecting growth in Highland U.K. (+70.1%) and modest growth in Highland North America (+5.8%), offset by a decrease in Highland Australia (-59.7%) as a result of the split off of part of that business as an independent brand licensee during the second quarter of 2005.

Highland's direct costs for the year ended December 31, 2005 were \$3.1 million compared to \$3.6 million for 2004. The lower direct costs were the result of lower reimbursed out-of-pocket expenses. On a constant currency basis, direct costs decreased 22.9% for 2005 in comparison to 2004.

Highland's gross margin for the year ended December 31, 2005 was \$59.7 million, higher by \$1.6 million, or 2.8%, from \$58.1 million reported for the year ended December 31, 2004. Gross margin, as a percentage of revenue, was 95.1%, for 2005, an increase from 94.2% for 2004. On a constant currency basis, gross margin increased by 2.3% for the year ended December 31, 2005 when compared to the year ended December 31, 2004.

Highland's selling, general and administrative expenses for the year ended December 31, 2005 were \$56.9 million on a reported basis and \$56.7 million in constant currency, essentially unchanged when compared with \$57.1 million for the same period of 2004. Selling general and administrative expenses, on a constant currency basis, were 91.1% and 92.5% as a percentage of revenue for the full years 2005 and 2004, respectively.

Highland's EBITDA for the year ended December 31, 2005 was \$4.5 million, higher by \$4.6 million from a loss of \$0.1 million reported for the year ended December 31, 2004. The increase is the result of improved results in Highland North America (\$4.4 million), Highland U.K. (\$1.6 million) and the absence of losses in continental Europe (\$0.4 million), offset by the decline of \$2.0 million in Highland Australia to a loss of \$0.9 million.

Highland's operating income was \$3.1 million for the year ended December 31, 2005, compared to a loss of \$1.9 million for the comparable period in 2004. Highland's 2005 improvement in operating results was primarily due to the same factors as discussed in EBITDA.

### ***Corporate and Other***

Corporate expenses for the year ended December 31, 2005 were \$36.1 million compared to \$33.5 million for 2004. The corporate expenses in 2005 increased primarily as a result of higher compensation expense, partially offset by lower marketing, depreciation and professional fee expenses.

**Table of Contents**

Other non-operating expense, including net interest expense, was \$0.8 million for the year ended December 31, 2005, lower by \$1.1 million when compared to \$1.9 million for the same period of 2004. Non-operating expense was lower due to the inclusion in 2004 of the loss on abandonment of Hudson Europe's German subsidiary and higher foreign currency transactional gains in 2005, offset by higher interest expense in 2005.

The provision for income taxes for the year ended December 31, 2005 was \$5.0 million on a pretax income of \$10.4 million, compared with a provision of \$1.6 million on a pretax loss of \$25.1 million for the same period of 2004. The change in the company's tax provision for the year ended December 31, 2005, compared to the same period in 2004, was primarily due to increased profits in the Asia Pacific region in countries where there are no tax loss carryforwards to offset taxable income. The effective tax rate differs from the U.S. Federal statutory rate of 35% due to the inability to recognize tax benefits on net US losses, primarily corporate expenses, partially offset by the release of the valuation allowance on deferred tax assets related to net operating loss carryforwards in tax jurisdictions where profits are now being generated. Other factors also include certain non-deductible expenses such as amortization, business restructuring and spin-off costs and merger costs from pooling of interests transactions, asset impairment charges, and variations from the U.S. tax rate in foreign jurisdictions.

Net income was \$5.3 million for the year ended December 31, 2005, compared to a net loss of \$26.8 million for 2004. Basic earnings per share were \$.24 and diluted earnings per share were \$.22, for the year ended December 31, 2005, compared to basic and diluted loss of \$1.38 per share in the year ended December 31, 2004. Basic average shares outstanding increased in 2005 as a result of various employee stock compensation awards that vested or were issued or granted at various times during 2005. For the 2004 period, dilutive earnings per share calculations do not differ from basic earnings per share because the effects of any potential common stock were anti-dilutive and therefore not included in the calculation of dilutive earnings per share.



**Table of Contents****The Year Ended December 31, 2004 Compared to the Year Ended December 31, 2003**

|   | As reported       | For the year ended December 31, |                      | 2003<br>As reported |
|---|-------------------|---------------------------------|----------------------|---------------------|
|   |                   | 2004<br>Currency<br>translation | Constant<br>currency |                     |
| <b>Revenue:</b>                                 |                   |                                 |                      |                     |
| Hudson Americas                                 | \$ 334,765        | \$ 203                          | \$ 334,968           | \$ 278,935          |
| Hudson Europe                                   | 447,483           | (46,074)                        | 401,409              | 364,766             |
| Hudson Asia Pacific                             | 412,427           | (44,507)                        | 367,920              | 377,555             |
| Highland  | 61,679            | (2,574)                         | 59,105               | 64,043              |
| <b>Total</b>                                    | <b>1,256,354</b>  | <b>(92,952)</b>                 | <b>1,163,402</b>     | <b>1,085,299</b>    |
| <b>Direct costs:</b>                            |                   |                                 |                      |                     |
| Hudson Americas                                 | 248,103           | 289                             | 248,392              | 213,715             |
| Hudson Europe                                   | 265,414           | (27,981)                        | 237,433              | 210,134             |
| Hudson Asia Pacific                             | 269,067           | (30,427)                        | 238,640              | 254,715             |
| Highland  | 3,550             | (423)                           | 3,127                | 3,706               |
| <b>Total</b>                                    | <b>786,134</b>    | <b>(58,542)</b>                 | <b>727,592</b>       | <b>682,270</b>      |
| <b>Gross margin:</b>                            |                   |                                 |                      |                     |
| Hudson Americas                                 | 86,662            | (86)                            | 86,576               | 65,220              |
| Hudson Europe                                   | 182,069           | (18,093)                        | 163,976              | 154,632             |
| Hudson Asia Pacific                             | 143,360           | (14,080)                        | 129,280              | 122,840             |
| Highland  | 58,129            | (2,151)                         | 55,978               | 60,337              |
| <b>Total</b>                                    | <b>\$ 470,220</b> | <b>\$ (34,410)</b>              | <b>\$ 435,810</b>    | <b>\$ 403,029</b>   |
| <b>Selling, general and administrative (1):</b> |                   |                                 |                      |                     |
| Hudson Americas                                 | 86,688            | (138)                           | 86,550               | 81,527              |
| Hudson Europe                                   | 185,873           | (18,682)                        | 167,191              | 172,007             |
| Hudson Asia Pacific                             | 126,165           | (13,209)                        | 112,956              | 121,942             |
| Highland  | 57,063            | (2,053)                         | 55,010               | 77,190              |
| Corporate                                       | 33,533            |                                 | 33,533               | 31,741              |
| <b>Total</b>                                    | <b>\$ 489,322</b> | <b>\$ (34,082)</b>              | <b>\$ 455,240</b>    | <b>\$ 484,407</b>   |

(1) Selling, general and administrative expenses include the Consolidated Statements of Operations captions: salaries and related, office and general, marketing and promotion, and depreciation and amortization.

**Hudson Americas**

Hudson Americas revenue was \$334.8 million for the year ended December 31, 2004, up 20.0% from \$278.9 million for the same period of 2003. The increase in revenue was from both Hudson North America's temporary services (+18%), especially Legal, Accounting & Finance and IT permanent placement services (+49%).

Hudson Americas direct costs for the year ended December 31, 2004 were \$248.1 million compared to \$213.7 million for 2003. The increase was primarily the result of direct costs for temporary contractors.

Hudson Americas gross margin for the year ended December 31, 2004 was \$86.7 million, higher by \$21.5 million, or 33%, from \$65.2 million reported for the year ended December 31, 2003. Gross margin, as a percentage of revenue, was 25.9%, for 2004, an increase from 23.4% for

2003.

---

**Table of Contents**

Hudson Americas' selling general and administrative costs were \$86.7 million for the year ended December 31, 2004, higher by 6.3% from \$81.5 million for the same period in 2003. Selling, general and administrative expenses were 25.9% and 29.2% as a percentage of revenue for the full years 2004 and 2003, respectively.

Hudson Americas' operating loss was \$0.9 million for the year ended December 31, 2004, compared to \$73.5 million for the same period of 2003. The decrease in the 2004 operating loss is primarily due to the absence of the 2003 goodwill impairment charge (\$55.4 million), improved operating results in North American businesses, which was partially offset by increased costs associated with the Hudson development groups, Center for High Performance and North American Hudson Talent Management.

***Hudson Europe***

Hudson Europe's revenue was \$447.5 million for the year ended December 31, 2004, up 22.7% from \$364.8 million for the same period of 2003. On a constant currency basis, Hudson Europe's revenue increased approximately 10% comparing 2004 to 2003. The largest constant currency revenue increases were achieved in Hudson United Kingdom from increased revenue in temporary contracting (+9%) and permanent placement (+27%) businesses, and Hudson Netherlands' higher human resources consulting business (+27%).

Hudson Europe's direct costs for the year ended December 31, 2004 were \$265.4 million compared to \$209.8 million for 2003. On a constant currency basis, direct costs increased 13.2% for 2004 in comparison to 2003.

Hudson Europe's gross margin for the year ended December 31, 2004 was \$182.1 million, higher by \$27.4, or 17.7%, from \$154.6 reported for the year ended December 31, 2003. Gross margin, as a percentage of revenue, was 40.7% for 2004, an increase from 42.4% for 2003. On a constant currency basis, gross margin increased by 6.0% for the year ended December 31, 2004 when compared to the year ended December 31, 2003.

Hudson Europe's selling general and administrative costs were \$185.9 million for the year ended December 31, 2004, higher by 8.0% from \$172.0 million for the same period in 2003. Selling, general and administrative expenses were 41.5% and 47.2% as a percentage of revenue for the full years 2004 and 2003, respectively. On a constant currency basis, the 2004 selling, general and administrative expenses decreased by 2.8%, compared to 2003.

Hudson Europe's operating loss was \$4.5 million for the year ended December 31, 2004, compared to \$158.5 million for the same period of 2003. The decrease in the 2004 operating loss was primarily due to the absence of the 2003 goodwill impairment charge (\$128.7 million), lower reorganization expenses (\$9.3 million), improved operating results in the United Kingdom business and the absence of losses resulting from the abandonment of the German subsidiary; this was partially offset by the higher losses in France compared to 2003.

***Hudson Asia Pacific***

Hudson Asia Pacific's revenue was \$412.4 million for the year ended December 31, 2004, up 9.2% from \$377.6 million for the same period of 2003. The increase was achieved due to Hudson Asia's improved permanent placement business (+51%), offset by decreases in Hudson Australia (-6%).

Hudson Asia Pacific's direct costs for the year ended December 31, 2004 were \$269.1 million compared to \$254.7 million for 2003. On a constant currency basis, direct costs decreased 6.3% for 2004 in comparison to 2003.

Hudson Asia Pacific's gross margin for the year ended December 31, 2004 was \$143.4 million, higher by \$20.5 million, or 16.7%, from \$122.8 million reported for the year ended December 31, 2003. Gross margin, as a

---

## **Table of Contents**

percentage of revenue, was 34.8%, for 2004, an increase from 32.5% for 2003. On a constant currency basis, gross margin increased by 5.2% for the year ended December 31, 2004 when compared to the year ended December 31, 2003.

Hudson Asia Pacific's selling, general and administrative costs were \$126.3 million for the year ended December 31, 2004, higher by 3.5% from \$121.9 million for the same period in 2003. Selling, general and administrative expenses were 30.6% and 32.3% as a percentage of revenue for the full years 2004 and 2003, respectively. On a constant currency basis, the 2004 selling, general and administrative expenses decreased by 7.3%, compared to 2003.

Hudson Asia Pacific's operating income was \$17.6 million for the year ended December 31, 2004, compared to an operating loss of \$14.7 million for the same period of 2003. The increase in the 2004 operating income is primarily due to the absence of the 2003 goodwill impairment charge (\$11.3 million), lower reorganization expenses (\$4.7 million) and improved operating results in the Australian, Asian and New Zealand businesses.

### ***Highland***

Highland revenue of \$61.7 million for the year ended December 31, 2004 was down 3.7% from \$64.0 million for 2003, reflecting the closure of its continental European operations, partially offset by an increase in the Highland Australian business (+93%) and modest growth in Highland North America (+2%). On a constant currency basis, Highland revenue decreased 8% comparing 2004 results with 2003, reflecting essentially the same factors noted previously and a decrease in Highland U.K. (-9%).

Highland's direct costs for the year ended December 31, 2004 were \$3.5 million compared to \$3.7 million for 2003. On a constant currency basis, direct costs decreased 15.6% for 2004 in comparison to 2003.

Highland's gross margin for the year ended December 31, 2004 was \$58.1 million, lower by \$2.2 million, or 3.7%, from \$60.3 million reported for the year ended December 31, 2003. Gross margin, as a percentage of revenue, remained unchanged from 2003 to 2004 at 94.2%. On a constant currency basis, gross margin decreased by 7.2% for the year ended December 31, 2004 when compared to the year ended December 31, 2003.

Highland's selling general and administrative costs were \$57.1 million for the year ended December 31, 2004, lower by 26.0% from \$77.2 million for the same period in 2003. Selling, general and administrative expenses were 92.6% and 120.5% as a percentage of revenue for the full years 2004 and 2003, respectively. On a constant currency basis, the 2004 selling, general and administrative expenses decreased by 28.7%, compared to 2003.

Highland's operating loss for the year ended December 31, 2004 was \$1.9 million compared to an operating loss of \$35.0 million for 2003. The 2004 loss was lower than 2003 as a result of lower business reorganization expenses (\$8.5 million), the absence of the 2003 goodwill impairment charge in 2004 (\$7.4 million), improved operating results (exclusive of goodwill impairment charges, reorganization expenses, and merger and integration expenses) in Highland North America (\$7.2 million), Highland United Kingdom (\$4.2 million) and Highland Australia (\$1.7 million), and the absence of losses from continental Europe (\$4.6 million), partially offset by higher merger and integration expenses (\$.6 million).

### ***Corporate and Other***

In the third quarter of 2003, the Company determined that goodwill should be tested for impairment due to current business conditions and changes in circumstances resulting from the Distribution, which established the Company as an independent entity with a separate market capitalization. As a result of this test and the related

---

**Table of Contents**

fair value examination, the Company recorded a non-cash goodwill impairment charge of \$202.8 million in 2003. The impairment valuation was based upon a discounted cash flow approach that used estimated future revenue and costs for each business segment as well as appropriate discount rates. The estimates that were used were consistent with the plans and estimates the Company was using to manage the underlying business. There were no comparable expenses in 2004.

Business reorganization expense for the year ended December 31, 2004 totaled \$3.4 million as compared to \$26.8 million in 2003. The 2004 expenses were additional costs and changes in estimates for the continuation of the process to streamline operations that had been previously announced in 2003 and 2002. In 2004, the primary changes were the result of costs related to the relocation of Highland's Toronto office and costs net of recoveries from certain U.S. and Hudson Australia office leases.

Merger and integration expenses reflect costs incurred as a result of pooling-of-interests transactions completed before June 2001 and the integration plans of such companies. For the year ended December 31, 2004, merger and integration costs were \$.7 million, a reduction of \$1.9 million from the prior year. Merger and integration expenses included lease obligations, office integration costs, and the write-off of fixed assets that will not be used in the future, and severance, professional fees and employee stay bonuses to certain key personnel of the merged companies.

Corporate expenses for the year ended December 31, 2004 were \$33.5 million compared to \$32.0 million for 2003, which included an allocation from Monster for the first quarter of 2003. The corporate expenses in 2004 increased primarily as a result of higher professional fees, including costs related to compliance with Sarbanes-Oxley Act of 2002 requirements, and marketing costs, partially offset by a decline in depreciation expense.

Other non-operating expense, including net interest expense, was \$1.9 million for the year ended December 31, 2004 and \$3.1 million for 2003. The expenses for 2004 included write-offs related to the abandonment of Hudson's German subsidiary. The decrease in 2004 expense compared to 2003 was the result of lower losses on sale and disposition of assets in 2004 (\$2.4 million), partially offset by the absence in 2004 of miscellaneous income from the settlement of a prior claim (\$1.2 million).

The provision for income taxes for the year ended December 31, 2004 was \$1.6 million on a pretax loss of \$25.1 million, compared with a provision of \$12.0 million on a pretax loss of \$316.8 million for the same period of 2003. The change in the Company's tax provision for the year ended December 31, 2004 compared to the same period in 2003 was primarily due to establishment of a valuation allowance in 2003 on certain foreign tax losses, the benefit of which may not be realizable, and the inability of the Company to realize benefits from its current losses in businesses where the future earnings ability to utilize those losses is not certain. Additionally, in 2004 the Company became a current taxpayer on certain income earned in the Asia Pacific region. In each period, the effective tax rate differs from the U.S. Federal statutory rate of 35% due to valuation allowance on deferred tax assets, net operating losses retained or utilized by Monster, certain non-deductible expenses such as amortization, business restructuring and spin-off costs, merger costs from pooling of interests transactions, asset impairment charges, and variations from the U.S. tax rate in foreign jurisdictions.

Net loss was \$26.8 million for the year ended December 31, 2004, compared with a loss of \$328.8 million for 2003. Basic and diluted loss per share for the year ended December 31, 2004 was a loss of \$1.38 per share, compared to a loss of \$19.58 per share in the year ended December 31, 2003. Basic average shares outstanding increased in 2004 as a result of the issuance of shares from a registered public offering in March 2004, a stock acquisition completed in June 2004 and various employee stock compensation awards that vested or were issued or granted at various time during 2004. For the 2004 and 2003 periods, dilutive earnings per share calculations did not differ from basic earnings per share because the effects of any potential common stock were anti-dilutive and therefore not included in the calculation of dilutive earnings per share.

---

## **Table of Contents**

### **Liquidity and Capital Resources**

The Company's liquidity needs arise primarily from funding working capital requirements and capital investment in information technology.

The Company filed a shelf registration on October 6, 2004 to enable it to issue up to 1,350,000 shares of its common stock from time to time in connection with acquisitions of businesses, assets or securities of other companies, whether by purchase, merger or any other form of acquisition or business combination. If any shares are issued using this shelf registration, the Company will not receive any proceeds from these offerings other than the assets, businesses or securities acquired. This shelf filing is still outstanding.

On July 6, 2005, the Company issued 3,223,640 shares of its common stock in a registered public offering and received \$45.0 million in net proceeds from the issuance. The Company has used and plans to continue to use the proceeds from the offering to fund the growth of worldwide staffing operations, make acquisitions and for general corporate purposes.

The Company has a senior secured credit facility for \$75.0 million (the "Credit Facility"). The maturity date of the Credit Facility is March 31, 2009. Outstanding loans will bear interest equal to the prime rate plus 0.25% or LIBOR plus 2.00%, at the Company's option and had a weighted average interest rate of 6.49% as of December 31, 2005. The Credit Facility is secured by substantially all of the assets of the Company and extensions of credit will be based on a percentage of the accounts receivable of the Company. The Company expects to use such credit, if and when required, to support its ongoing working capital requirements, capital expenditures and other corporate purposes and to support letters of credit. As of December 31, 2005, the credit limit on the Credit Facility was \$75 million. As of December 31, 2005, the Company had outstanding borrowings of \$30.1 million and letters of credit issued and outstanding of approximately \$15.5 million under the Credit Facility. Available credit for use under the Credit Facility as of December 31, 2005 was \$29.4 million. Letters of credit are used to support certain of the Company's office leases, the worker's compensation policy and its finance leases.

The Credit Facility contains various restrictions and covenants, including (1) prohibitions on payments of dividends and repurchases of the Company's stock; (2) requirements that the Company maintain its minimum Adjusted EBITDA (as defined in the Credit Facility) and capital expenditures within prescribed levels; (3) restrictions on the ability of the Company to make additional borrowings, or to consolidate, merge or otherwise fundamentally change the ownership of the Company; and (4) limitations on investments, dispositions of assets and guarantees of indebtedness. On March 9, 2006, the Company entered into an amendment to the Credit Facility that established minimum Adjusted EBITDA (measured on a trailing twelve-month basis) and maximum capital expenditure covenant levels for fiscal year 2006. The minimum Adjusted EBITDA covenant generally provides that the Company's Adjusted EBITDA for the trailing twelve-month periods ending March 31, June 30, September 30 and December 31, 2006 may not be less than \$15.0 million, \$15.0 million, \$25.0 million and \$25.0 million, respectively. The maximum capital expenditure covenant provides that the Company's capital expenditures for 2006 may not exceed \$14.0 million. These restrictions and covenants could limit the Company's ability to respond to market conditions, to provide for unanticipated capital investments, to raise additional debt or equity capital, to pay dividends or to take advantage of business opportunities, including future acquisitions.

During the years ended December 31, 2005 and 2004, the Company used cash in operating activities of \$26.3 million and \$30.9 million, respectively. Cash usage for operating activities decreased in 2005 compared to 2004 as a result of an increase in net income (\$32.1 million) and lower payments related to the legacy reorganization and merger plans (\$3.8 million), partially offset by higher usage to fund higher levels of accounts receivable (\$12.9 million), primarily related to billing issues and growth in the Hudson North American business, and lower benefits from other working capital liabilities and other assets.

During the years ended December 31, 2005 and 2004, the Company used cash in investing activities of \$35.7 million and \$10.1 million, respectively. This use of cash was primarily related to capital expenditures in

**Table of Contents**

the normal course of operations and payments related to business acquisitions. The increased use of cash in 2005 compared to 2004 was the result of higher payments related to purchases of businesses, primarily Balance, in 2005 (\$25.4 million).

During the years ended December 31, 2005 and 2004, the Company generated cash from financing activities of \$75.9 million and \$35.3 million, respectively. The cash provided from financing activities was higher in 2005 compared to 2004, as a result of a net increase in borrowings under the credit facility (\$30.1 million) and higher proceeds from the 2005 stock issuance compared to the 2004 stock issuance (\$17.0 million).

The Company believes that the cash and cash equivalents on hand at December 31, 2005, supplemented by availability under the Credit Facility, will provide it with sufficient liquidity to satisfy its working capital needs, capital expenditures, investment requirements and commitments through at least the next twelve months.

**Future Capital Requirements**

The Company's near-term cash requirements are primarily related to funding operations, a portion of prior year restructuring actions and capital expenditures. However, the Company cannot provide assurance that actual cash requirements will not be greater in the future from those currently expected. If sources of liquidity are not available or if the Company cannot generate sufficient cash flow from operations, the Company might be required to obtain additional sources of funds through additional operating improvements, capital market transactions, asset sales or financing from third parties, or a combination thereof. The Company cannot provide assurance that these additional sources of funds will be available or, if available, would have reasonable terms.

*Off-Balance Sheet Arrangements.* As of December 31, 2005, the Company had no off-balance sheet arrangements.

*Contractual Obligations.* The Company has entered into various commitments that will affect its cash generation capabilities going forward. Particularly, it has entered into several non-cancelable operating leases for facilities and equipment worldwide. Future contractual obligations as of December 31, 2005 are as follows (dollars in thousands) (commitments based in currencies other than U.S. dollars were translated using exchange rates as of December 31, 2005):

| <b>Contractual Obligation (a)</b>   | <b>Less than 1 year</b> | <b>1 to 3 years</b> | <b>3 to 5 years</b> | <b>More than 5 years</b> | <b>Total</b>      |
|-------------------------------------|-------------------------|---------------------|---------------------|--------------------------|-------------------|
| Operating lease obligations         | \$ 32,667               | \$ 51,730           | \$ 37,873           | \$ 74,398                | \$ 196,668        |
| Capital lease obligations (b)       | 2,471                   | 478                 |                     |                          | 2,949             |
| <b>Other long term liabilities:</b> |                         |                     |                     |                          |                   |
| Reorganization expenses             | 4,223                   | 3,168               | 927                 |                          | 8,318             |
| Merger and integration expenses     | 1,239                   | 1,378               | 557                 | 103                      | 3,277             |
| <b>Total</b>                        | <b>\$ 40,600</b>        | <b>\$ 56,754</b>    | <b>\$ 39,357</b>    | <b>\$ 74,501</b>         | <b>\$ 211,212</b> |

(a) Other long-term liabilities of \$2,648, primarily related to mandated employee benefit obligations, do not have readily determinable payment periods and are therefore not included in the schedule.

(b) Capital lease obligations presented here exclude the interest portion of the obligation, which is immaterial.

**REGARDING FORWARD-LOOKING STATEMENTS**

This Form 10-K contains statements that the Company believes to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this Form 10-K, including statements regarding the Company's future financial condition, results of operations, business operations and business prospects, are forward-looking statements. Words such as anticipate, estimate, expect, project, intend, plan, predict, believe and similar words, expressions and variations of them and expressions are intended to identify forward-looking

## **Table of Contents**

statements. All forward-looking statements are subject to important factors, risks, uncertainties and assumptions, including industry and economic conditions that could cause actual results to differ materially from those described in the forward-looking statements. Such factors, risks, uncertainties and assumptions include, but are not limited to, (1) the Company's history of negative cash flows and operating losses may continue, (2) the ability of clients to terminate their relationship with the Company at any time, (3) the impact of global economic fluctuations on the Company's temporary contracting operations, (4) restrictions on the Company's operating flexibility due to the terms of its credit facility, (5) risks relating to the Company's foreign operations, including foreign currency fluctuations, (6) risks and financial impact associated with acquisitions; (7) the Company's heavy reliance on information systems and the impact of potentially losing or failing to develop technology, (8) competition in the Company's markets and the Company's dependence on highly skilled professionals, (9) fluctuations in the Company's operating results from quarter to quarter, (10) the impact of employees departing with existing executive search clients, (11) restrictions imposed by blocking arrangements, (12) the Company's exposure to employment-related claims from both clients and employers and limits on related insurance coverage, (13) the Company's dependence on key management personnel and (14) the impact of government regulations. These forward-looking statements speak only as of the date of this Form 10-K. The Company assumes no obligation, and expressly disclaims any obligation, to update any forward-looking statements, whether as a result of new information, future events or otherwise.

### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The majority of the Company's long-term borrowings are in fixed rate capital leases for leasehold improvements, computer software and computer equipment. The carrying amounts of long-term debt approximate fair value, generally due to the short-term nature of the underlying instruments. We do not trade derivative financial instruments for speculative purposes.

The Company also conducts operations in various foreign countries, including Australia, Belgium, Canada, France, the Netherlands, New Zealand and the United Kingdom. For the year ended December 31, 2005, the Company earned approximately 72% of its gross margin outside the United States, and it collected payments in local currency and related operating expenses were paid in such corresponding local currency. Accordingly, the Company is subject to increased risk for exchange rate fluctuations between such local currencies and the U.S. dollar.

The financial statements of the non-U.S. subsidiaries are translated into U.S. dollars using current rates of exchange, with translation gains or losses included in the cumulative translation adjustment account, a component of stockholders' equity. During the year ended December 31, 2005, the Company had a translation loss of \$6.9 million, primarily attributable to the strengthening of the U.S. dollar against the British pound, the Euro and the Australian dollar.

The Company's objective is to reduce earnings and cash flow volatility associated with foreign exchange rate changes. Accordingly, the Company enters into foreign currency forward contracts to minimize the exposure to foreign exchange rate risk related to intercompany loan balances denominated in currencies other than the functional currency. At December 31, 2005, no foreign currency forward contracts were outstanding. The principal currencies hedged during the year ended December 31, 2005 were the Euro, the British pound, and the Australian Dollar.

The Company had no derivative instruments outstanding at December 31, 2005.



**Table of Contents**

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Management's Annual Report on Internal Control Over Financial Reporting**

The Company's management, with the participation of the Company's Chairman of the Board and Chief Executive Officer and Executive Vice President and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as December 31, 2005.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 using the criteria set forth in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, the Company's management believes that, as of December 31, 2005, the Company's internal control over financial reporting was effective based on those criteria.

The Company's independent registered public accounting firm, BDO Seidman, LLP, has issued an attestation report on management's assessment of the Company's internal control over financial reporting. That attestation report is set forth immediately following the report of BDO Seidman, LLP on the financial statements included herein.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Board of Directors

Hudson Highland Group, Inc.

New York, New York

We have audited the accompanying consolidated balance sheets of Hudson Highland Group, Inc. as of December 31, 2005 and 2004, and the related consolidated statements of operations, cash flows and stockholders' equity for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hudson Highland Group, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the internal control over financial reporting of Hudson Highland Group, Inc. as of December 31, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 10, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ BDO SEIDMAN, LLP  
BDO Seidman, LLP  
New York, New York

March 10, 2006

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Board of Directors

Hudson Highland Group, Inc.

New York, New York

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting appearing under Item 8, that Hudson Highland Group, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management of Hudson Highland Group, Inc. is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the internal control over financial reporting of Hudson Highland Group, Inc. based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Hudson Highland Group, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. Also, in our opinion, Hudson Highland Group, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Hudson Highland Group, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated March 10, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ BDO SEIDMAN, LLP  
BDO Seidman, LLP  
New York, New York

March 10, 2006



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except share and per share amounts)**

|   | Year Ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2005                    | 2004         | 2003         |
| Revenue   | \$ 1,428,276            | \$ 1,256,354 | \$ 1,085,299 |
| Direct costs (Note 2)                           | 891,345                 | 786,134      | 682,270      |
| Gross margin                                    | 536,931                 | 470,220      | 403,029      |
| Operating expenses:                             |                         |              |              |
| Salaries and related                            | 375,519                 | 347,245      | 318,070      |
| Office and general                              | 112,684                 | 101,318      | 122,081      |
| Marketing and promotion                         | 18,981                  | 20,651       | 22,957       |
| Depreciation and amortization                   | 18,412                  | 20,108       | 21,299       |
| Business reorganization expenses                | 233                     | 3,361        | 26,823       |
| Merger and integration (recoveries) expenses    | (70)                    | 736          | 2,663        |
| Goodwill impairment charge                      |                         |              | 202,785      |
| Total operating expenses                        | 525,759                 | 493,419      | 716,678      |
| Operating income (loss)                         | 11,172                  | (23,199)     | (313,649)    |
| Other income (expense):                         |                         |              |              |
| Interest, net                                   | (1,852)                 | (104)        | (283)        |
| Other, net                                      | 1,029                   | (1,834)      | (2,859)      |
| Income (loss) before provision for income taxes | 10,349                  | (25,137)     | (316,791)    |
| Provision for income taxes                      | 5,036                   | 1,638        | 12,021       |
| Net income (loss)                               | \$ 5,313                | \$ (26,775)  | \$ (328,812) |
| Income (loss) per share:                        |                         |              |              |
| Basic   | \$ 0.24                 | \$ (1.38)    | \$ (19.58)   |
| Diluted   | \$ 0.22                 | \$ (1.38)    | \$ (19.58)   |
| Weighted average shares outstanding:            |                         |              |              |
| Basic   | 22,295,000              | 19,457,000   | 16,797,000   |
| Diluted   | 23,674,000              | 19,457,000   | 16,797,000   |

See accompanying notes to consolidated financial statements.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share amounts)

|   | December 31, |            |
|---|--------------|------------|
|   | 2005         | 2004       |
| <b>ASSETS</b>   |              |            |
| Current assets:   |              |            |
| Cash and cash equivalents   | \$ 34,108    | \$ 21,064  |
| Accounts receivable, less allowance for doubtful accounts of \$5,488 and \$5,230, respectively                        | 232,081      | 197,582    |
| Prepaid and other   | 14,330       | 14,187     |
| Total current assets  | 280,519      | 232,833    |
| Property and equipment, net   | 31,438       | 36,360     |
| Intangibles, net  | 31,100       | 6,104      |
| Other assets  | 5,359        | 6,081      |
| Total assets  | \$ 348,416   | \$ 281,378 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |              |            |
| Current liabilities:  |              |            |
| Accounts payable  | \$ 24,718    | \$ 27,023  |
| Accrued expenses and other current liabilities  | 140,036      | 140,903    |
| Credit facility and current portion of long-term debt   | 32,544       | 4,066      |
| Accrued business reorganization expenses  | 4,223        | 8,930      |
| Accrued merger and integration expenses   | 1,239        | 1,872      |
| Total current liabilities   | 202,760      | 182,794    |
| Accrued business reorganization expenses, non-current   | 4,095        | 6,832      |
| Accrued merger and integration expenses, non-current  | 2,038        | 3,329      |
| Other long-term liabilities   | 5,948        | 2,648      |
| Long-term debt, less current portion  | 478          | 2,041      |
| Total liabilities   | 215,319      | 197,644    |
| Commitments and contingencies   |              |            |
| Stockholders' equity:   |              |            |
| Preferred stock, \$0.001 par value, 10,000,000 shares authorized; none issued or outstanding                          |              |            |
| Common stock, \$0.001 par value, 100,000,000 shares authorized; issued 24,340,462 and 20,612,966 shares, respectively | 24           | 21         |
| Additional paid-in capital  | 404,755      | 353,825    |
| Accumulated deficit   | (306,263)    | (311,576)  |
| Accumulated other comprehensive income translation adjustments  | 34,811       | 41,694     |
| Treasury stock, 15,798 and 15,798 shares, respectively  | (230)        | (230)      |
| Total stockholders' equity  | 133,097      | 83,734     |
|   | \$ 348,416   | \$ 281,378 |

See accompanying notes to consolidated financial statements.



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|   | Year Ended December 31, |             |              |
|---|-------------------------|-------------|--------------|
|   | 2005                    | 2004        | 2003         |
| Cash flows from operating activities:   |                         |             |              |
| Net income (loss)   | \$ 5,313                | \$ (26,775) | \$ (328,812) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities:    |                         |             |              |
| Depreciation and amortization   | 18,412                  | 20,108      | 21,299       |
| (Recovery of) provision for doubtful accounts   | 2,233                   | (683)       | 13,482       |
| Provision for (benefit from) deferred income taxes                                      | 1,021                   | (1,424)     | 11,082       |
| Compensation charge on restricted stock issuance  | 795                     | 971         | 467          |
| Net (gain) loss on disposal of assets   | (559)                   | 1,330       | 3,962        |
| Goodwill impairment charge  |                         |             | 202,785      |
| Changes in assets and liabilities, net of effects of business acquisitions:             |                         |             |              |
| (Increase) decrease in accounts receivable, net   | (51,974)                | (39,054)    | 21,003       |
| (Increase) decrease in other assets   | (2,313)                 | 9,700       | 2,260        |
| Increase (decrease) in accounts payable, accrued expenses and other current liabilities | 9,113                   | 17,083      | 13,734       |
| Decrease in accrued business reorganization expenses                                    | (6,688)                 | (9,900)     | (1,404)      |
| Decrease in accrued merger and integration expenses                                     | (1,651)                 | (2,251)     | (2,487)      |
| Total adjustments   | (31,611)                | (4,120)     | 286,183      |
| Net cash used in operating activities   | (26,298)                | (30,895)    | (42,629)     |
| Cash flows from investing activities:   |                         |             |              |
| Capital expenditures  | (9,933)                 | (9,735)     | (10,710)     |
| Payments for acquisitions and intangible assets, net of cash acquired                   | (25,782)                | (393)       | (680)        |
| Net cash used in investing activities   | (35,715)                | (10,128)    | (11,390)     |
| Cash flows from financing activities:   |                         |             |              |
| Proceeds from issuance of common stock  | 44,961                  | 27,919      |              |
| Borrowings under credit facility  | 355,644                 | 19,550      |              |
| Repayments under credit facility  | (325,571)               | (19,550)    |              |
| Net payments on long-term debt  | (2,791)                 | (1,407)     | (1,166)      |
| Issuance of common stock Long Term Incentive Plan option exercises                      | 1,472                   | 1,790       |              |
| Issuance of common stock employee stock purchase plans                                  | 2,142                   | 1,688       | 1,302        |
| Payments received from Monster  |                         | 5,518       | 8,012        |
| Purchase of restricted stock from employees   |                         | (230)       |              |
| Net cash transfers received from Monster, prior to Distribution                         |                         |             | 41,317       |
| Net cash provided by financing activities   | 75,857                  | 35,278      | 49,465       |
| Effect of exchange rates on cash and cash equivalents                                   | (800)                   | 672         | 4,783        |
| Net increase (decrease) in cash and cash equivalents                                    | 13,044                  | (5,073)     | 229          |
| Cash and cash equivalents, beginning of year  | 21,064                  | 26,137      | 25,908       |
| Cash and cash equivalents, end of year  | \$ 34,108               | \$ 21,064   | \$ 26,137    |



See accompanying notes to consolidated financial statements.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

(in thousands, except share amounts)

|  | Common stock |       | Additional paid-in |       | Treasury stock | Accumulated (deficit) earnings | Divisional equity | Accumulated other comprehensive income (loss) | Total      | Total comprehensive (loss) income |
|--|--------------|-------|--------------------|-------|----------------|--------------------------------|-------------------|---|------------|-----------------------------------|
|  | Shares       | Value | capital            |       |                |                                |                   |   |            |                                   |
| Balance January 1, 2003  |              | \$    | \$                 |       | \$             | \$                             | \$ 291,914        | \$ 24,660                                     | \$ 316,574 |                                   |
| Net loss January 1, 2003 to March 31, 2003                                   |              |       |                    |       |                |                                | (44,011)          |   | (44,011)   | \$ (44,011)                       |
| Cash transfers from Monster  |              |       |                    |       |                |                                | 41,317            |   | 41,317     |                                   |
| Non-cash equity contributions from Monster                                   |              |       |                    |       |                |                                | 24,150            |   | 24,150     |                                   |
| Transfer of divisional equity to common stock and additional paid-in capital | 16,763,216   | 16    | 313,354            |       |                |                                | (313,370)         |   |            |                                   |
| Net loss April 1, 2003 to December 31, 2003                                  |              |       |                    |       |                |                                | (284,801)         |   | (284,801)  | (284,801)                         |
| Other comprehensive income, translation adjustments                          |              |       |                    |       |                |                                |                   | 14,363  | 14,363     | 14,363                            |
| Issuance of shares for employee stock purchase plans                         | 197,554      | 1     | 1,301              |       |                |                                |                   |   | 1,302      |                                   |
| Restricted stock issuance and related compensation charge                    | 184,750      |       | 467                |       |                |                                |                   |   | 467        |                                   |
| Balance December 31, 2003  | 17,145,520   | 17    | 315,122            |       |                |                                | (284,801)         | 39,023  | 69,361     | \$ (314,449)                      |
| Net loss   |              |       |                    |       |                |                                | (26,775)          |   | (26,775)   | \$ (26,775)                       |
| Other comprehensive income, translation adjustments                          |              |       |                    |       |                |                                |                   | 2,671   | 2,671      | 2,671                             |
| Issuance of shares for 401(k) plan contribution                              | 92,076       |       | 1,058              |       |                |                                |                   |   | 1,058      |                                   |
| Issuance of shares from exercise of stock options                            | 252,074      | 1     | 1,789              |       |                |                                |                   |   | 1,790      |                                   |
| Issuance of shares for employee stock purchase plans                         | 159,590      |       | 1,688              |       |                |                                |                   |   | 1,688      |                                   |
| Issuance of shares   | 2,547,770    | 2     | 27,917             |       |                |                                |                   |   | 27,919     |                                   |
| Purchase of restricted stock from employees                                  | (15,798)     |       |                    | (230) |                |                                |                   |   | (230)      |                                   |
| Issuance of shares for acquisition   | 367,174      | 1     | 5,280              |       |                |                                |                   |   | 5,281      |                                   |
| Restricted stock issuance and related compensation charge                    | 48,762       |       | 971                |       |                |                                |                   |   | 971        |                                   |
| Balance December 31, 2004  | 20,597,168   | 21    | 353,825            | (230) | (311,576)      |                                |                   | 41,694  | 83,734     | \$ (24,104)                       |
| Net income   |              |       |                    |       |                |                                | 5,313             |   | 5,313      | 5,313                             |
| Other comprehensive loss, translation adjustments                            |              |       |                    |       |                |                                |                   | (6,883)                                       | (6,883)    | (6,883)                           |
| Issuance of shares for 401(k) plan contribution                              | 94,960       |       | 1,563              |       |                |                                |                   |   | 1,563      |                                   |
| Issuance of shares from exercise of stock options                            | 187,038      |       | 1,472              |       |                |                                |                   |   | 1,472      |                                   |
| Issuance of shares for employee stock purchase plans                         | 167,583      |       | 2,142              |       |                |                                |                   |   | 2,142      |                                   |
| Issuance of shares   | 3,223,640    | 3     | 44,958             |       |                |                                |                   |   | 44,961     |                                   |

## Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|   |            |       |            |          |              |    |           |            |    |         |
|---|------------|-------|------------|----------|--------------|----|-----------|------------|----|---------|
| Restricted stock issuance and related compensation charge | 54,275     |       | 795        |          |              |    |           | 795        |    |         |
| Balance December 31, 2005                                 | 24,324,664 | \$ 24 | \$ 404,755 | \$ (230) | \$ (306,263) | \$ | \$ 34,811 | \$ 133,097 | \$ | (1,570) |

See accompanying notes to consolidated financial statements.

---

**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share and per share amounts)**

**1. BASIS OF PRESENTATION AND DESCRIPTION OF BUSINESS**

**Basis of Presentation**

Hudson Highland Group, Inc. and its subsidiaries (the Company) comprise the operations, assets and liabilities of the three Hudson regional businesses (Hudson Regional Businesses or Hudson regions) and Highland Partners (Highland). The Company was historically the combination of 67 acquisitions made between 1999 and 2002, which became the eResourcing and Executive Search divisions (HH Group) of Monster Worldwide, Inc. (Monster), formerly TMP Worldwide, Inc. Some of the Company's constituent businesses have operated for more than 20 years. Immediately prior to the Distribution, Monster transferred substantially all the assets and liabilities of its eResourcing and Executive Search business segments to HH Group. These assets and liabilities are reflected in HH Group's financial statements at Monster's historical cost. On March 31, 2003 (the Distribution Date), Monster distributed all of the outstanding shares of the newly named HH Group to its stockholders of record on March 14, 2003 on a basis of one share of HH Group common stock for each thirteen and one-third shares of Monster common stock so held (the Distribution). Since the Distribution, the Company has operated as an independent publicly held company, has completed three acquisitions, and reorganized a number of smaller business units after determining that those businesses were not viable profit centers.

The consolidated financial statements have been derived from the financial statements and accounting records of Monster for all periods through the Distribution Date, using the historical results of operations and historical basis of the assets and liabilities of the Company's business. In connection with the Distribution, the inter-company balances due to Monster were contributed by Monster to equity. Accordingly, such balances are reflected as divisional equity for periods prior to March 31, 2003, at which time the amount was reclassified to common stock and additional paid-in capital. Earnings and losses are accumulated in accumulated (deficit) earnings starting April 1, 2003. The terms of the distribution agreement with Monster did not require repayment or distribution of any portion of the divisional equity back to Monster. HH Group's costs and expenses in the accompanying consolidated financial statements for periods prior to March 31, 2003 included allocations from Monster for executive, legal, accounting, treasury, real estate, information technology and other Monster corporate services and infrastructure costs because specific identification of the expenses is not practicable. The total corporate services allocation to HH Group from Monster was \$5,123 for the year ended December 31, 2003. The expense allocation was determined on the basis that Monster and HH Group considered to be reasonable reflections of the utilization of services provided or the benefit received by HH Group using ratios that are primarily based on the Company's revenue, net of direct costs of temporary contractors, compared to Monster as a whole. Monster also allocated to HH Group certain merger and integration expenses and business reorganization expenses of \$137 for the year ended December 31, 2003, which were included in corporate expenses. The financial information included herein prior to March 31, 2003 may not necessarily reflect the financial position and results of operations of the Company in the future or what these amounts would have been had it been a separate, stand-alone entity during the periods presented prior to the Distribution.

**Reporting Segments**

The Company is one of the world's largest specialized professional staffing, retained executive search and talent management solutions firms. The Company provides professional staffing services on a permanent, contract and temporary basis, as well as executive search and a range of human capital services to businesses operating in a wide variety of industries. The Company reassessed its reportable segments in the fourth quarter of 2005 and prior period results are presented in conformity with the 2005 presentation. The Company is organized into four reportable segments, the three Hudson regional businesses of Hudson Americas, Hudson Europe, and Hudson Asia Pacific, and Highland, which constituted approximately 21%, 38%, 29% and 11% of the Company's gross margin, respectively, for the year ended December 31, 2005.

**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

*Hudson Regional Businesses.* Hudson's three regions provide temporary and contract personnel and permanent recruitment services to a wide range of clients. With respect to temporary and contract personnel, Hudson focuses on providing candidates with specialized functional skills and competencies, such as accounting and finance, legal and information technology. The length of a temporary assignment can vary, but engagements at the professional level tend to be longer than those in the general clerical or industrial sectors. With respect to permanent recruitment, Hudson focuses on mid-level professionals typically earning between \$50,000 and \$150,000 annually and possessing the professional skills and/or profile required by clients. Hudson provides permanent recruitment services on both a retained and contingent basis. In larger markets, Hudson's sales strategy focuses on both clients operating in particular industry sectors, such as financial services, health care, or technology, and candidates possessing particular professional skills, such as accounting and finance, information technology, legal and human resources. Hudson uses both traditional and interactive methods to select potential candidates for its clients, employing a suite of products that assesses talent and help predict whether a candidate will be successful in a given role.

All of the Hudson regional businesses also provide organizational effectiveness and development services through their Talent Management Solutions units. These services encompass candidate assessment, competency modeling, leadership development, performance management, and career transition. These services enable Hudson to offer clients a comprehensive set of management services, across the entire employment life cycle, from attracting, assessing and selecting best-fit employees to engaging and developing those individuals to help build a high-performance organization. Through the Hudson Center for High Performance (the Center for High Performance), the Company also offers leadership solutions designed to assist senior management in enhancing the operating performance of their organizations.

Hudson Americas operates from 48 offices in two countries, with 96% of its 2005 gross margin generated in the United States. Hudson Europe operates from 48 offices in 17 countries, with 58% of its 2005 gross margin coming from the United Kingdom operations. Hudson Asia Pacific operates from 25 offices in 6 countries, with 65% of its 2005 gross margin stemming from Australia.

*Highland.* Highland, an executive search boutique with global reach, offers a comprehensive range of executive search services on a retained basis aimed exclusively at recruiting senior level executives. Highland also has a specialized practice that assists clients desiring to enhance their boards of directors.

Highland approaches the market through industry sectors, such as financial services, life sciences, retail and consumer products and technology. This industry sector sales approach is designed to enable Highland to better understand the strategic management issues and market conditions faced by clients within their specific business segments. Highland also recruits candidates through functional specialist groups, including those focused on boards of directors and senior officers in the finance, information technology, human resources and legal professions.

Highland operates in 14 practice offices in four countries. For the year ended December 31, 2005, approximately 75% of gross margin in the Highland business was derived in North America.

Corporate expenses are reported separately from the four reportable segments and consist primarily of expenses for compensation, marketing programs, rent and professional consulting.

**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and all of its wholly-owned and majority-owned subsidiaries. All significant intercompany accounts and transactions between and among the Company and its subsidiaries have been eliminated in consolidation. Transactions and balances between the Company and Monster are included in the accompanying consolidated financial statements.

**Nature of Business and Credit Risk**

The Company's revenue is earned from executive placement services, mid-level employee professional staffing and temporary contracting services. These services are provided to a large number of customers in many different industries. The Company operates principally throughout North America, the United Kingdom, Continental Europe and the Asia Pacific region (primarily Australia).

Financial instruments, which potentially subject the Company to concentrations of credit risk, are primarily cash and accounts receivable. The Company performs continuing credit evaluations of its customers and does not require collateral. The Company has not experienced significant losses related to receivables from individual customers or groups of customers in any particular industry or geographic area.

**Fair Value of Financial Instruments**

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the immediate or short-term maturity of these financial instruments.

The carrying amount reported for long-term debt approximates fair value generally due to the short-term nature of the underlying instruments.

**Foreign Currency Risk Management**

The Company periodically enters into forward contracts to reduce exposure to exchange rate risk related to short-term intercompany loans denominated in currencies other than the functional currency. The Company does not apply hedge accounting, and all gains and losses are included in other expense. The Company does not trade derivative financial instruments for speculative purposes. Prior to the Distribution Date, the Company historically participated in Monster's centralized treasury function.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates include, among others, allocations of costs to the Company by Monster for 2003 and prior, allowances for doubtful accounts, net realizable values for long-lived assets, and the recoverability of deferred tax assets. Actual results could differ from these estimates.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**Revenue Recognition**

Although the Company's revenue recognition policy involves a relatively low level of uncertainty, it does require judgment on complex matters that is subject to multiple sources of authoritative guidance.

*Hudson Regional Businesses.* The Company recognizes revenue for temporary services at the time services are provided and revenue is recorded on a time and materials basis. Temporary contracting revenue is reported gross when the Company acts as the principal in the transaction and is at risk for collection. Revenues that do not meet the criteria for gross revenue reporting are reported on a net basis. Revenue generated when the Company permanently places an individual with a client on a contingent basis is recorded at the time of acceptance of employment, net of an allowance for estimated fee reversals. Revenue generated when the Company permanently places an individual with a client on a retained basis is recorded ratably over the period services are rendered, net of an allowance for estimated fee reversals.

*Highland.* Substantially all professional fee revenue is derived from fees for professional services related to executive recruitment, consulting and related services performed on a retained basis. Fee revenue is generally one-third of the estimated first year compensation and reimbursed expenses, plus a percentage of the fee to cover indirect expenses. Fee revenue from executive recruitment is recognized when such services are earned. The Company generally bills clients in three monthly installments. Fees earned in excess of the initial contract amount are recognized at completion of the engagement. Reimbursed out-of-pocket expenses are included in revenue.

Revenue, direct costs and gross margin of the Company were as follows:

|              | Year ended December 31, 2005 |            |              | Year ended December 31, 2004 |            |              | Year ended December 31, 2003 |            |              |
|--------------|------------------------------|------------|--------------|------------------------------|------------|--------------|------------------------------|------------|--------------|
|              | Temporary                    | Other      | Total        | Temporary                    | Other      | Total        | Temporary                    | Other      | Total        |
| Revenue      | \$ 1,034,174                 | \$ 394,102 | \$ 1,428,276 | \$ 886,971                   | \$ 369,383 | \$ 1,256,354 | \$ 775,674                   | \$ 309,625 | \$ 1,085,299 |
| Direct costs | 847,872                      | 43,473     | 891,345      | 732,786                      | 53,348     | 786,134      | 644,011                      | 38,259     | 682,270      |
| Gross margin | \$ 186,302                   | \$ 350,629 | \$ 536,931   | \$ 154,185                   | \$ 316,035 | \$ 470,220   | \$ 131,663                   | \$ 271,366 | \$ 403,029   |

**Direct Costs and Gross Margin**

Direct costs include the direct staffing costs of salaries, payroll taxes, employee benefits, travel expenses and insurance costs for the Company's temporary contractors and reimbursed out-of-pocket expense and other direct costs. Other than reimbursed out-of-pocket expenses, there are no other direct costs associated with the Other category, which includes search, permanent placement and other human resource solutions revenue. Gross margin represents revenue less direct costs. The region where services are provided, the mix of temporary and permanent placements, and the functional nature of the staffing services provided can affect gross margin.

**Operating Expenses**

Salaries and related expenses include the salaries, commissions, payroll taxes and employee benefits related to recruitment professionals, executive level employees, administrative staff and other employees of the Company who are not temporary contractors. Office and general expenses include occupancy, equipment leasing and maintenance, utilities, travel expenses, professional fees and provision for doubtful accounts. The Company expenses the costs of advertising as incurred.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)****Accounts Receivable**

The Company's accounts receivable balances are composed of trade and unbilled receivables. The Company maintains an allowance for doubtful accounts and makes ongoing estimates as to the ability to collect on the various receivables. If the Company determines that the allowance for doubtful accounts is not adequate to cover estimated losses, an expense to provide for doubtful accounts is recorded in office and general expenses. If an account is determined to be uncollectible, it is written off against the allowance for doubtful accounts. Management's assessment and judgment are vital requirements in assessing the ultimate realization of these receivables, including the current credit-worthiness, financial stability and effect of market conditions on each customer.

**Cash and Cash Equivalents**

Cash and cash equivalents, which consist primarily of commercial paper and time deposits, are stated at cost, which approximates fair value. For financial statement presentation purposes, the Company considers all highly liquid investments having an original maturity of three months or less as cash equivalents. At December 31, 2005 and 2004, outstanding checks in excess of cash account balances were \$4,661 and \$3,929, respectively, and are included in accounts payable on the accompanying balance sheet.

The Company participated in Monster's cash management program until the Distribution Date, and Monster substantially funded the Company's cash requirements until the Distribution Date.

**Property and Equipment**

Property and equipment are stated at cost. Depreciation is computed primarily using the straight-line method over the following estimated useful lives:

|                            | <b>Years</b> |
|----------------------------|--------------|
| Furniture and equipment    | 3 - 7        |
| Capitalized software costs | 2 - 5        |
| Computer equipment         | 3 - 4        |

Leasehold improvements are amortized over the shorter of their estimated useful lives or the lease term. The amortization periods of material leasehold improvements are made at the inception of the lease term.

**Capitalized Software Costs**

Capitalized software costs consist of costs to purchase and develop software for internal use. The Company capitalizes certain incurred software development costs in accordance with the American Institute of Certified Public Accountants (AICPA) Statement of Position No. 98-1, *Accounting for the Cost of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). Costs incurred during the application-development stage for software bought and further customized by outside vendors for the Company's use and software developed by a vendor for the Company's proprietary use have been capitalized. Costs incurred for the Company's own personnel who are directly associated with software development are capitalized as appropriate. Capitalized software costs are included in property and equipment.

**Intangibles**

Intangibles represent acquisition costs in excess of the fair value of net tangible assets of businesses purchased and consist primarily of client lists, trademarks and goodwill. With the exception of goodwill, these





**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

costs are being amortized over periods ranging from three to five years on a straight-line basis or on an accelerated basis where appropriate. The Company evaluates its goodwill annually for impairment, or earlier if indicators of potential impairment exist.

**Long-Lived Assets**

Long-lived assets, such as intangibles (except for goodwill), and property and equipment, are evaluated for impairment when events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of these assets and its eventual disposition are less than its carrying amount. Impairment, if any, is assessed using discounted cash flows.

**Foreign Currency Translation**

The financial position and results of operations of the Company's foreign subsidiaries are determined using local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the exchange rate in effect at each year-end. Statements of Operations accounts are translated at the average rate of exchange prevailing during each period. Translation adjustments arising from the use of differing exchange rates from period to period are included in the other comprehensive income / (loss) account in stockholders' equity. Gains and losses resulting from other foreign currency transactions are included in other income (expense).

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating loss and tax credit carry-forwards, and tax contingencies. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company records a valuation allowance against deferred tax assets to the extent that it is more likely than not that some portion, or all of, the deferred tax assets will not be realized.

For the periods prior to the Distribution, the Company was not a separate taxable entity for federal, state or local income tax purposes and its operating results were included in Monster's tax returns. The Company calculated its income taxes under the separate return method and accounted for deferred tax assets and liabilities under the asset and liability method described above. Tax benefits absorbed by Monster prior to the Distribution Date were charged as a reduction to divisional equity.

As a result of the Company's inability to recognize a current tax benefit from the exercise of stock options, no credits have been recorded to additional paid-in capital for the benefit from stock option exercises for all periods presented.

**Earnings (Loss) Per Share**

Basic earnings (loss) per share is computed by dividing the Company's earnings (losses) by the weighted average number of shares outstanding during the period. When the effects are not anti-dilutive, diluted earnings per share is computed by dividing the Company's net earnings by the weighted average number of shares outstanding and the impact of all dilutive potential common shares, primarily stock options. The dilutive impact of stock options and unvested restricted stock is determined by applying the treasury stock method. For periods in which a loss is presented, dilutive earnings per share calculations do not differ from basic earnings per share.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)**

because the effects of any potential common stock were anti-dilutive and, therefore, not included in the calculation of dilutive earnings per share. For the year ended December 31, 2005 the difference between weighted average basic and diluted common shares outstanding was composed of potential common stock from options of 1,237,000 and unvested restricted stock of 142,000. For the years ended December 31, 2004 and 2003, the effect of approximately 930,000 and 860,000, respectively, of outstanding stock options and other common stock equivalents was excluded from the calculation of diluted loss per share because the effect was anti-dilutive.

Earnings (loss) per share calculations for each quarter include the weighted average effect for the quarter; therefore, the sum of quarterly earnings (loss) per share amounts may not equal year-to-date earnings (losses) per share amounts, which reflect the weighted average effect on a year-to-date basis.

**Comprehensive Income (Loss)**

Comprehensive income (loss) is defined to include all changes in equity except those resulting from investments by owners and distributions to owners. The Company's other comprehensive (loss) income is solely comprised of foreign currency translation adjustments, which relate to investments that are permanent in nature. To the extent that such amounts relate to investments that are permanent in nature, no adjustments for income taxes are made.

**Stock-Based Compensation**

The Company accounts for employee stock-based compensation in accordance with APB No. 25. Under APB No. 25, no compensation expense is recognized in connection with the awarding of stock option grants to employees provided that, as of the grant date, all terms associated with the award are fixed and the quoted market price of the stock is equal to or less than the amount an employee must pay to acquire the stock. Any options issued with an exercise price below the quoted market price on the date of the approved grant have a related compensation expense, which is recognized in the accompanying financial statements. The Company adopted the disclosure only provisions of SFAS 123 and SFAS 148, which require certain financial statement disclosures, including pro forma operating results as if the Company had prepared its consolidated financial statements in accordance with the fair value based method of accounting for stock-based compensation.

The Company currently uses the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of traded options that have no restrictions and are fully transferable and negotiable in a free trading market. Black-Scholes does not consider the employment, transfer or vesting restrictions that are inherent in the Company's employee options. Use of an option valuation model, as required by SFAS 123, includes highly subjective assumptions based on long-term predictions, including the expected stock price volatility and average life of each option grant.

As required under SFAS 123 and SFAS 148, the pro forma effects of stock-based compensation on the Company's operating results and per share data have been estimated at the date of grant using the Black-Scholes option-pricing model based on the following weighted average assumptions:

|  | Year ended December 31, |         |         |
|--|-------------------------|---------|---------|
|  | 2005                    | 2004    | 2003    |
| Risk free interest rate  | 4.0%                    | 4.0%    | 4.0%    |
| Volatility   | 55.0%                   | 55.0%   | 65.0%   |
| Expected life (years)  | 5.0                     | 5.0     | 5.0     |
| Dividends  |                         |         |         |
| Weighted average fair value of options granted during the period | \$ 7.52                 | \$ 7.21 | \$ 4.36 |



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)**

For purposes of pro forma disclosures, the options' estimated fair value is assumed to be amortized to expense over the options' vesting periods. The pro forma effects of recognizing compensation expense under the fair value method on the Company's operating results and per share data are as shown below. As a result of the Company's inability to recognize current tax benefits on reported net losses, total stock-based compensation expense is shown without tax benefits for all periods presented:

|   | Year ended December 31, |                    |                     |
|---|-------------------------|--------------------|---------------------|
|   | 2005                    | 2004               | 2003                |
| Reported net income (loss)  | \$ 5,313                | \$ (26,775)        | \$ (328,812)        |
| Less: Total stock-based employee compensation expense determined under fair value based method for all awards | (4,469)                 | (3,510)            | (3,714)             |
| <b>Pro forma net income (loss)</b>  | <b>\$ 844</b>           | <b>\$ (30,285)</b> | <b>\$ (332,526)</b> |
| Earnings (loss) per share:  |                         |                    |                     |
| As reported basic net income (loss):  | \$ .24                  | \$ (1.38)          | \$ (19.58)          |
| As reported diluted net income (loss)   | \$ .22                  | \$ (1.38)          | \$ (19.58)          |
| Pro forma net income (loss):  |                         |                    |                     |
| Basic   | \$ .04                  | \$ (1.56)          | \$ (19.80)          |
| Diluted   | \$ .04                  | \$ (1.56)          | \$ (19.80)          |

**Effect of Recently Issued Accounting Standards**

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment. Statement 123(R)* (SFAS 123R). SFAS 123R replaces SFAS 123 and supersedes APB No. 25. SFAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, SFAS 123 permitted entities the option of continuing to apply the guidance in APB No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. SFAS 123R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123R requires the cost of all share-based payment transactions be recognized in the financial statements, establishes fair value as the measurement objective and requires entities to apply a fair-value-based measurement method in accounting for share-based payment transactions. The statement applies to all awards granted, modified, repurchased or cancelled after July 1, 2005, and unvested portions of previously issued and outstanding awards.

The SEC amended the effective date of SFAS 123R with a new rule issued on April 14, 2005 to amend the compliance date for SFAS 123R that allows companies to implement SFAS 123R at the beginning of their next fiscal year, instead of the next reporting period, that begins after June 15, 2005, although early adoption is allowed. SFAS 123R permits companies to adopt its requirements using either a modified prospective method, or a modified retrospective method. Under the modified prospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements of SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. Under the modified retrospective method, the requirements are the same as under the modified prospective method, but also permits entities to restate financial statements of previous periods based on pro forma disclosures made in accordance with SFAS 123.

The Company will adopt SFAS 123R effective January 1, 2006 and will use the aforementioned modified retrospective method. Based upon the stock options granted and estimates of employee contributions to the



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

Employee Stock Purchase Plan and subject to a complete management review, the Company expects the adoption of SFAS 123R would reduce pre-tax income and net income by approximately \$4,900 for the year ended 2006, or \$0.20 per basic share and \$0.19 per diluted share, based upon current stock compensation plans and estimated weighted average number of shares outstanding. As a result of the Company's inability to recognize current tax benefits on reported net losses, tax benefits are not expected to be recorded in the near future. The Company has not changed any of its stock compensation plans as a result of the impending adoption of SFAS 123R, but maintains the right to amend, suspend or terminate any plan at any time.

On December 16, 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* (SFAS 153). The amendments made by SFAS 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company's adoption of SFAS 153 on July 1, 2005 did not have an effect on its consolidated financial statements.

**Reclassifications**

In the current financial statement presentation, changes have been made from presentations in prior Securities and Exchange Commission filings and new account descriptions are being used. Certain prior period amounts have been reclassified to conform to the Company's 2005 financial statement presentation; these reclassifications do not change total revenue, total expenses, net loss, total assets, total liabilities or stockholders equity.

**3. PROPERTY AND EQUIPMENT**

Property and equipment, net consisted of the following:

|   | December 31, |           |
|---|--------------|-----------|
|   | 2005         | 2004      |
| Computer equipment                              | \$ 31,204    | \$ 31,634 |
| Furniture and equipment                         | 23,257       | 23,497    |
| Capitalized software costs                      | 33,410       | 29,645    |
| Leasehold and building improvements             | 21,771       | 25,723    |
| Transportation equipment                        | 1,077        | 1,295     |
|   | 110,719      | 111,794   |
| Less: Accumulated depreciation and amortization | 79,281       | 75,434    |
| Property and equipment, net                     | \$ 31,438    | \$ 36,360 |

Leasehold improvements included assets classified under capital leases at December 31, 2005 and 2004 with a cost of \$725 and \$4,152, respectively, and accumulated amortization of \$52 and \$1,416, respectively. Capitalized software costs included software under capital leases at December 31, 2005 and 2004 with a cost of \$4,714 and \$2,722, respectively and accumulated amortization of \$466 and \$0, respectively. Computer equipment included equipment classified under capital leases at December 31, 2005 and 2004 with a cost of \$153 and \$153, respectively, and accumulated amortization of \$76 and \$25, respectively.





**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**4. GOODWILL AND INTANGIBLES**

SFAS 142 requires that goodwill and indefinite-lived intangible assets not be amortized but be tested for impairment on an annual basis, or more frequently if circumstances warrant.

In the third quarter of 2003, the Company determined that under the requirements of SFAS 142, goodwill should be tested for impairment due to business conditions and changes in circumstances resulting from the Distribution, which established the Company as an independent entity with a separate market capitalization. As a result of this test and the related fair value examination, the Company recorded a non-cash goodwill impairment charge of \$202,785, in operating expenses. The impairment valuation was based upon a discounted cash flow approach that used estimated future revenue and costs for each business segment as well as appropriate discount rates. The estimates that were used are consistent with the plans and estimates the Company was using to manage the underlying business. The 2003 goodwill impairment charge wrote off all goodwill previously recorded.

A summary of changes in the Company's goodwill by reporting unit follows. Additions in 2005 reflect acquisitions and purchase price adjustments made during the year, as described in Note 6.

|                     | December 31,<br>2004 | Additions and<br>adjustments | Impairments | Currency<br>translation | December 31,<br>2005 |
|---------------------|----------------------|------------------------------|-------------|-------------------------|----------------------|
| Hudson Americas     | \$ 4,567             | \$ 1,455                     | \$          | \$                      | \$ 6,022             |
| Hudson Europe       |                      | 15,400                       |             | (90)                    | 15,310               |
| Hudson Asia Pacific |                      |                              |             |                         |                      |
| Highland            |                      |                              |             |                         |                      |
|                     | \$ 4,567             | \$ 16,855                    | \$          | \$ (90)                 | \$ 21,332            |

|                     | December 31,<br>2003 | Additions and<br>adjustments | Impairments | Currency<br>translation | December 31,<br>2004 |
|---------------------|----------------------|------------------------------|-------------|-------------------------|----------------------|
| Hudson Americas     | \$                   | \$ 4,567                     | \$          | \$                      | \$ 4,567             |
| Hudson Europe       |                      |                              |             |                         |                      |
| Hudson Asia Pacific |                      |                              |             |                         |                      |
| Highland            |                      |                              |             |                         |                      |
|                     | \$                   | \$ 4,567                     | \$          | \$                      | \$ 4,567             |

|                     | December<br>31,<br>2002 | Additions<br>and<br>adjustments | Impairments | Currency<br>translation | December<br>31,<br>2003 |
|---------------------|-------------------------|---------------------------------|-------------|-------------------------|-------------------------|
| Hudson Americas     | \$ 55,351               | \$                              | \$ (55,351) | \$                      | \$                      |
| Hudson Europe       | 128,556                 |                                 | (128,707)   | (151)                   |                         |
| Hudson Asia Pacific | 9,602                   |                                 | (11,346)    | (1,744)                 |                         |
| Highland            | 7,251                   |                                 | (7,381)     | (130)                   |                         |

|    |         |    |  |    |           |    |         |    |
|----|---------|----|--|----|-----------|----|---------|----|
| \$ | 200,760 | \$ |  | \$ | (202,785) | \$ | (2,025) | \$ |
|----|---------|----|--|----|-----------|----|---------|----|

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

As of December 31, 2005 and 2004, intangible assets consisted of the following:

|  | December 31, 2005     |                          | December 31, 2004     |                          |
|--|-----------------------|--------------------------|-----------------------|--------------------------|
|  | Gross carrying amount | Accumulated amortization | Gross Carrying amount | Accumulated amortization |
| Goodwill                                       | \$ 21,322             | \$                       | \$ 4,567              | \$                       |
| Amortizable intangible assets:                 |                       |                          |                       |                          |
| Client lists and other amortizable intangibles | 14,702                | (4,924)                  | 4,243                 | (2,706)                  |
| Total intangible assets                        | \$ 36,024             | \$ (4,924)               | \$ 8,810              | \$ (2,706)               |

Amortization of intangible assets was \$2,286, \$646 and \$712, for the years ended December 31, 2005, 2004 and 2003, respectively. Estimated intangible asset amortization expense is \$4,200, \$2,700, \$1,500 and \$1,200 for the years ended December 31, 2006, 2007, 2008 and 2009, respectively.

**5. BUSINESS REORGANIZATION EXPENSES**

In 2003, the Company recorded additional charges and credits as a result of changes in estimates related to the prior actions and as a result of further actions in 2003 to close offices and business units that did not have the size or market capacity to provide future income growth.

As a result of the reorganization initiatives, the Company recorded business reorganization expenses of \$233, \$3,361 and \$26,823, classified as a component of operating expenses, for the years ended December 31, 2005, 2004 and 2003, respectively.

**Consolidation of Excess Facilities**

During the year ended December 31, 2005, the Company recorded expense of \$309 for changes in estimates. During the year ended December 31, 2004, the Company recorded expense of \$2,492 for changes in estimates and finalization of Highland's Canadian subleases and the signed modification of a Hudson Australian lease and other changes in estimates due to market fluctuations. During the year ended December 31, 2003, the Company recorded expense of \$6,951 for changes in estimate on facilities involved in the 2002 actions, primarily due to lower estimated sublease income and the inability to sublease certain locations. Additional charges of \$7,284 were recorded in 2003 to close additional locations that were in excess of the space required by the Company's operations. As of December 31, 2005 the remaining accrual related to approximately 28 locations and will be paid over the remaining lease terms, which have various expiration dates up until 2010, except one with a 2020 expiration date. The estimated payments for 2006 are \$3,192.

**Workforce Reduction**

During the years ended December 31, 2005 and 2004, credits of \$124 and \$201 were recorded for changes in prior year's estimates. During the year ended December 31, 2003, charges of \$1,505 were incurred for the continuation of the 2002 reorganization actions and \$8,744 was incurred for additional reductions in the workforce of approximately 220 employees. As of December 31, 2005, the workforce reduction accrual related to settlements and termination payments for approximately seven former employees, which are all payable in 2006.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**Professional Fees and Other Charges**

Professional fees and other charges were \$48 and \$1,070 in the years ended December 31, 2005 and 2004, respectively, related to prior reorganization actions and were primarily related to services required to close the Hudson Australian lease modification in 2004. Professional fees and other charges were \$2,339 in the year ended December 31, 2003. This accrual at December 31, 2005 was included in current liabilities.

Amounts under the Utilization caption of the following tables are primarily the cash payments associated with the plans. Business reorganization expense activities and liability balances were as follows:

| Year ended December 31, 2005       | December 31,<br>2004 | Changes in<br>estimate | Additional<br>charges | Utilization | December 31,<br>2005 |
|------------------------------------|----------------------|------------------------|-----------------------|-------------|----------------------|
| Consolidation of excess facilities | \$ 12,894            | \$ 309                 | \$                    | \$ (5,916)  | \$ 7,287             |
| Workforce reduction                | 663                  | (124)                  |                       | (177)       | 362                  |
| Professional fees and other        | 2,205                | 48                     |                       | (1,584)     | 669                  |
| Total                              | \$ 15,762            | \$ 233                 | \$                    | \$ (7,677)  | \$ 8,318             |

| Year ended December 31, 2004       | December 31,<br>2003 | Changes in<br>estimate | Additional<br>charges | Utilization | December 31,<br>2004 |
|------------------------------------|----------------------|------------------------|-----------------------|-------------|----------------------|
| Consolidation of excess facilities | \$ 18,340            | \$ 2,492               | \$                    | \$ (7,938)  | \$ 12,894            |
| Workforce reduction                | 5,337                | (201)                  |                       | (4,473)     | 663                  |
| Professional fees and other        | 2,706                | 1,070                  |                       | (1,571)     | 2,205                |
| Total                              | \$ 26,383            | \$ 3,361               | \$                    | \$ (13,982) | \$ 15,762            |

| Year ended December 31, 2003       | December 31,<br>2002 | Changes in<br>estimate | Additional<br>charges | Utilization | December 31,<br>2003 |
|------------------------------------|----------------------|------------------------|-----------------------|-------------|----------------------|
| Consolidation of excess facilities | \$ 15,048            | \$ 6,951               | \$ 7,284              | \$ (10,943) | \$ 18,340            |
| Workforce reduction                | 8,375                | 1,505                  | 8,744                 | (13,287)    | 5,337                |
| Professional fees and other        | 2,422                | 706                    | 1,633                 | (2,055)     | 2,706                |
| Total                              | \$ 25,845            | \$ 9,162               | \$ 17,661             | \$ (26,285) | \$ 26,383            |

The following table presents a summary of plan activity related to business reorganization costs by plan period.

| Year ended December 31, 2005 | December 31,<br>2004 | Changes in<br>estimate | Additional<br>charges | Utilization | December 31,<br>2005 |
|------------------------------|----------------------|------------------------|-----------------------|-------------|----------------------|
| Second Quarter 2002 Plan     | \$ 3,062             | \$ 320                 | \$                    | \$ (1,973)  | \$ 1,409             |
| Fourth Quarter 2002 Plan     | 7,921                | 5                      |                       | (2,930)     | 4,996                |
| Fourth Quarter 2003 Plan     | 4,779                | (92)                   |                       | (2,774)     | 1,913                |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|                                     |                              |                                |                               |                    |                              |
|-------------------------------------|------------------------------|--------------------------------|-------------------------------|--------------------|------------------------------|
| Total                               | \$ 15,762                    | \$ 233                         | \$                            | \$ (7,677)         | \$ 8,318                     |
|                                     | <b>December 31,<br/>2003</b> | <b>Changes in<br/>estimate</b> | <b>Additional<br/>charges</b> | <b>Utilization</b> | <b>December 31,<br/>2004</b> |
| <b>Year ended December 31, 2004</b> |                              |                                |                               |                    |                              |
| Second Quarter 2002 Plan            | \$ 4,717                     | \$ 1,011                       | \$                            | \$ (2,666)         | \$ 3,062                     |
| Fourth Quarter 2002 Plan            | 8,523                        | 2,683                          |                               | (3,285)            | 7,921                        |
| Fourth Quarter 2003 Plan            | 13,143                       | (333)                          |                               | (8,031)            | 4,779                        |
| Total                               | \$ 26,383                    | \$ 3,361                       | \$                            | \$ (13,982)        | \$ 15,762                    |

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

| Year ended December 31, 2003 | December 31,<br>2002 | Changes in<br>estimate | Additional<br>charges | Utilization | December 31,<br>2003 |
|------------------------------|----------------------|------------------------|-----------------------|-------------|----------------------|
| Second Quarter 2002 Plan     | \$ 14,908            | \$ 180                 | \$                    | \$ (10,371) | \$ 4,717             |
| Fourth Quarter 2002 Plan     | 10,937               | 8,982                  |                       | (11,396)    | 8,523                |
| Fourth Quarter 2003 Plan     |                      |                        | 17,661                | (4,518)     | 13,143               |
| Total                        | \$ 25,845            | \$ 9,162               | \$ 17,661             | \$ (26,285) | \$ 26,383            |

**6. BUSINESS COMBINATIONS MERGER AND INTEGRATION EXPENSES****Acquisitions Accounted for Using the Purchase Method**

On August 17, 2005, the Company and its subsidiary Hudson Group Holdings B.V. completed the acquisition of all of the shares of Balance Ervaring op Projectbasis B.V. ( Balance ), a leading professional temporary and contract-staffing firm in the Netherlands, pursuant to a Share Purchase Agreement (the Purchase Agreement ), dated July 19, 2005. The Purchase Agreement provided for a payment at closing of 17,750 euros, up to 3,000 euros paid into escrow to be paid to the sellers in 2006 based upon 2005 earnings thresholds for Balance, and additional earn-out payments of up to 4,250 euros, based on higher earnings thresholds for Balance from 2005 through 2007. If and when such payments come due, the amounts paid will be added to the recorded value of goodwill. Converted to U.S. dollars, the payment in euros at closing including escrow and all costs totaled \$24,210 (net of cash acquired of \$1,900). The Company recorded the allocation of the purchase price to the estimated fair value of the net assets acquired of approximately \$9,410 in current assets, \$8,650 in current liabilities, \$500 in non-current assets and \$10,800 for amortizable intangible assets (primarily customer base (\$7,100) and trade name (\$3,400), to be amortized on an accelerated basis that matches the estimated discounted cash flows related to the assets over their estimated useful lives of 3 to 5 years), \$3,250 for deferred tax liabilities and the balance of \$15,400 allocated to non-amortizable goodwill, which is not deductible for tax purposes. SFAS No. 141, Business Combinations ( SFAS 141 ) requires disclosure of pro forma results as though the business combination had been completed as of the beginning of the periods being reported. The following unaudited pro forma results are not necessarily indicative of the results that would have been achieved if the Company had acquired Balance at the beginning of the periods presented: net income for the twelve month period ended December 31, 2005 would have been approximately \$7,120 (\$0.32 per basic share and \$0.30 per diluted share). The effect on net loss and loss per share for the year ended December 31, 2004 and on annual revenue in 2004 and 2005 would not have been material. The Company also purchased a Ukrainian business in August 2005 for \$117.

The results of the Balance and other 2005 acquired businesses have been included in the Hudson Europe segment of the consolidated financial statements since the respective dates of acquisition.

On June 2, 2004, the Company purchased one business through the issuance of 367,174 shares of its common stock, with a fair value of \$5,281. The results of this business have been included in the Hudson segment of the consolidated financial statements since that date. The Company recorded the preliminary allocation of the purchase price to the estimated fair value of the net assets acquired (\$1,258 in assets, \$544 in liabilities) with the excess of \$4,567 allocated to goodwill, which may be deductible for tax purposes. The purchase agreement provides for contingent payouts to the sellers over the next three years, based upon future minimum annual and cumulative earnings thresholds. If and when such payments come due, the amounts paid will be added to the recorded value of goodwill. Pursuant to this purchase agreement, the Company paid a contingent payout of \$1,455 to the sellers in July 2005 and the amount paid was added to the recorded value of goodwill.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**Merger and Integration Expenses Incurred with Pooling of Interests Transactions**

In connection with pooling of interests transactions completed prior to June 30, 2001, the Company formulated plans to integrate the operations of such companies. Such plans involved the closure of certain offices of the acquired and merged companies and the termination of certain management and employees. The objectives of the plans were to eliminate redundant facilities and personnel, and to create a single brand in the related markets in which the Company operates.

The Company adjusted its estimates of these merger and integration costs by recognizing an expense reduction of \$70 for the year ended December 31, 2005 and expenses of \$736 and \$2,663 for the year ended December 31, 2004 and 2003, respectively, which consisted primarily of additional changes in the estimated costs of assumed leases and changes in sub-lease income from acquisitions.

Amounts reflected in the Expense column in the following tables represent changes in estimates to established plans subsequent to finalization. Amounts under the Utilization caption of the following tables are primarily the cash payments associated with the plans.

Accrued integration expense activities and liability balances consisted of:

| Year ended December 31, 2005                   | December 31,<br>2004 | Adjustments to |          | Utilization | December 31,<br>2005 |
|--|----------------------|----------------|----------|-------------|----------------------|
|  |                      | Goodwill       | Expenses |             |                      |
| Assumed lease obligations on closed facilities | \$ 5,201             | \$             | \$ (70)  | \$ (1,854)  | \$ 3,277             |
| Total  | \$ 5,201             | \$             | \$ (70)  | \$ (1,854)  | \$ 3,277             |

| Year ended December 31, 2004                   | December<br>31,<br>2003 | Adjustments to |          | Utilization | December<br>31,<br>2004 |
|--|-------------------------|----------------|----------|-------------|-------------------------|
|  |                         | Goodwill       | Expenses |             |                         |
| Assumed lease obligations on closed facilities | \$ 6,709                | \$             | \$ 736   | \$ (2,244)  | \$ 5,201                |
| Consolidation of acquired facilities           | 460                     |                |          | (460)       |                         |
| Total  | \$ 7,169                | \$             | \$ 736   | \$ (2,704)  | \$ 5,201                |

| Year ended December 31, 2003                   | December 31,<br>2002 | Adjustments to |          | Utilization | December 31,<br>2003 |
|--|----------------------|----------------|----------|-------------|----------------------|
|  |                      | Goodwill       | Expenses |             |                      |
| Assumed lease obligations on closed facilities | \$ 7,983             | \$             | \$ 2,693 | \$ (3,967)  | \$ 6,709             |
| Consolidation of acquired facilities           | 1,607                |                | (30)     | (1,117)     | 460                  |
| Severance, relocation and other employee costs | 36                   |                |          | (36)        |                      |
| Total  | \$ 9,626             | \$             | \$ 2,663 | \$ (5,120)  | \$ 7,169             |

Costs associated with assumed lease obligations on closed facilities relate to leased office locations of acquired companies that were either under-utilized prior to the acquisition date or closed by the Company in connection with acquisition-related restructuring plans. The amount is based on the present value of minimum future lease obligations, net of estimated sublease income. The estimated payments for 2006 are \$1,239, with the remaining balance paid over the terms of the eight leases that end in 2015.

## Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

Costs associated with the consolidation of existing offices of acquired companies relate to termination costs of contracts relating to billing systems, external reporting systems and other contractual arrangements with third parties.



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

The following tables present a summary of activity relating to the Company's integration plans for acquisitions made in prior years by the year of acquisition.

| Year ended December 31, 2005 | December 31,<br>2004 | Expenses | Utilization | December 31,<br>2005 |
|------------------------------|----------------------|----------|-------------|----------------------|
| 2000 Plans                   | \$ 2,407             | \$ (35)  | \$ (701)    | \$ 1,671             |
| 2001 Plans                   | 800                  | (35)     | (309)       | 456                  |
| 2002 Plans                   | 1,994                |          | (844)       | 1,150                |
| Total                        | \$ 5,201             | \$ (70)  | \$ (1,854)  | \$ 3,277             |

| Year ended December 31, 2004 | December 31,<br>2003 | Expenses | Utilization | December 31,<br>2004 |
|------------------------------|----------------------|----------|-------------|----------------------|
| 2000 Plans                   | \$ 2,453             | \$ 595   | \$ (641)    | \$ 2,407             |
| 2001 Plans                   | 2,293                | (80)     | (1,413)     | 800                  |
| 2002 Plans                   | 2,423                | 221      | (650)       | 1,994                |
| Total                        | \$ 7,169             | \$ 736   | \$ (2,704)  | \$ 5,201             |

**7. SUPPLEMENTAL CASH FLOW INFORMATION**

|   | Year Ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2005                    | 2004     | 2003     |
| Interest paid   | \$ 2,741                | \$ 1,498 | \$ 2,312 |
| Income taxes paid   | \$ 3,313                | \$ 1,195 | \$ 60    |
| Value of common stock issued to satisfy 401(k) contribution (a) | \$ 1,563                | \$ 1,058 |          |
| Capital lease obligations                                       | \$ 2,079                | \$ 3,920 |          |
| Fair value of common stock issued for acquisition (b)           |                         | \$ 5,281 |          |

(a) The Company issued 94,960 and 92,076 shares of its common stock in 2005 and 2004, respectively.

(b) The Company issued 367,174 shares of common stock to purchase a business in its Hudson Americas segment.

**8. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consisted of the following:

|                                    | December 31, |           |
|------------------------------------|--------------|-----------|
|                                    | 2005         | 2004      |
| Salaries, commissions and benefits | \$ 77,604    | \$ 69,836 |
| Sales, use and income taxes        | 23,737       | 27,098    |
| Fees for professional services     | 5,794        | 7,340     |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|                |            |            |
|----------------|------------|------------|
| Rent           | 5,030      | 3,038      |
| Other accruals | 27,871     | 33,591     |
|                | \$ 140,036 | \$ 140,903 |

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)****9. LONG-TERM DEBT**

Long-term debt consisted of the following:

|  | <b>December 31,</b> |                 |
|--|---------------------|-----------------|
|  | <b>2005</b>         | <b>2004</b>     |
| Capitalized lease obligations, payable with interest from 6.0% to 7.2%, in varying installments through 2008 | \$ 2,949            | \$ 6,107        |
| Less: Current portion  | 2,471               | 4,066           |
|  | <b>\$ 478</b>       | <b>\$ 2,041</b> |

As of December 31, 2005, long-term debt matures as follows: \$2,471 in 2006, \$220 in 2007 and \$258 in 2008. Certain of the leases can be paid prior to the scheduled maturity. Capital lease obligations presented here exclude the interest portion of the obligation, which is immaterial.

**10. STOCK COMPENSATION PLANS**

The Company adopted all the stock compensation plans and savings plans listed below subsequent to the Distribution.

The Company maintains the Hudson Highland Group, Inc. Long Term Incentive Plan (the "LTIP") pursuant to which it granted 1,389,000, 267,100 and 1,579,712 stock options to purchase shares of the Company's common stock to certain key employees during the years ended December 31, 2005, 2004 and 2003, respectively. Options outstanding have vesting periods of three to four years. Options with three-year lives vest 50% on the first anniversary of the date of grant and 25% on each of the two succeeding anniversaries of the date of grant. Options with four-year lives vest 25% on each of the four anniversary dates. All options granted in 2005 and 2004 had four-year vesting periods. Options exercisable within one year from December 31, 2005 totaled 936,190. No options related to the common stock of Monster were converted at the Distribution into options to purchase the Company's stock.

The Company granted 250,000 options to purchase shares of the Company's common stock under the LTIP to five non-employee members of the Board of Directors in 2003. These options had an immediate vesting of 40% of the options granted with the remaining options vesting evenly over the next three years. Of these options 10,000 have been exercised and the remaining 240,000 were outstanding as of December 31, 2005. Options exercisable within one year from December 31, 2005 totaled 240,000.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)**

Restricted stock activity for the three years ended December 31, 2005 follows:

|   | Year Ended December 31, |          |         |
|---|-------------------------|----------|---------|
|   | 2005                    | 2004     | 2003    |
| Opening balance unvested restricted stock | 138,625                 | 184,750  |         |
| Grants issued with three year vesting (a) |                         |          | 130,750 |
| Grants issued with four year vesting (b)  | 53,000                  | 50,000   | 54,000  |
| Grants issued with immediate vesting (c)  | 4,000                   | 5,600    |         |
| Grants canceled                           | (2,063)                 | (7,500)  |         |
| Grants vested with three year vesting (a) | (24,812)                | (55,625) |         |
| Grants vested with four year vesting (b)  | (26,500)                | (19,500) |         |
| Grants vested due to accelerated vesting  |                         | (13,500) |         |
| Grants vested with immediate vesting (c)  | (4,000)                 | (5,600)  |         |
| Ending balance unvested restricted stock  | 138,250                 | 138,625  | 184,750 |
| Average grant price                       | \$ 24.28                | \$ 13.32 | \$ 8.23 |
| Restricted stock expense (d)              | \$ 795                  | \$ 971   | \$ 467  |

- (a) Restricted stock with a three-year vesting period vests 50% on the first anniversary of the date of grant and 25% on each of the two succeeding anniversaries of the date of grant.
- (b) Restricted stock with a four-year vesting period vests 25% on each of the four anniversary dates.
- (c) Restricted shares that vested immediately were granted to a total of 77 employees as performance awards.
- (d) The value of the restricted stock at the date of grant is amortized over the related vesting period as a charge to compensation expense and an increase in additional paid-in capital. These shares are provided at no cost to the employee.

Stock option activity for the three years ended December 31, 2005 follows:

|                               | LTIP                       |                               | Weighted average exercise price per share |
|-------------------------------|----------------------------|-------------------------------|---|
|                               | shares available for grant | Number of options outstanding |   |
| April 1, 2003 shares reserved | 2,000,000                  |                               |   |
| Options granted               | (1,829,712)                | 1,829,712                     | \$ 7.34                                   |
| Restricted shares granted     | (184,750)                  |                               |   |
| Options forfeited/canceled    | 55,112                     | (55,112)                      | 6.87                                      |
| As of December 31, 2003       | 40,650                     | 1,774,600                     | 7.36                                      |
| Additional shares reserved    | 1,000,000                  |                               |   |
| Options granted               | (267,100)                  | 267,100                       | 13.66                                     |
| Restricted shares granted     | (55,600)                   |                               |   |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|                                      |             |           |          |
|--------------------------------------|-------------|-----------|----------|
| Options exercised                    |             | (252,074) | 6.58     |
| Options forfeited/canceled           | 146,760     | (146,760) | 7.94     |
| Options expired                      |             | (1,000)   | 6.83     |
| Restricted shares forfeited/canceled | 7,500       |           |          |
| As of December 31, 2004              | 872,210     | 1,641,866 | 8.37     |
| Additional shares reserved           | 1,500,000   |           |          |
| Options granted                      | (1,389,000) | 1,389,000 | 15.78    |
| Restricted shares granted            | (57,000)    |           |          |
| Options exercised                    |             | (187,038) | 8.48     |
| Options forfeited/canceled           | 48,413      | (48,413)  | 11.44    |
| Option expired                       |             | (1,250)   | 8.54     |
| Restricted shares forfeited/canceled | 2,063       |           |          |
| As of December 31, 2005              | 976,686     | 2,794,165 | \$ 11.57 |

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

The following table summarizes stock options information at December 31, 2005:

| Range of<br>exercise<br>prices | Options outstanding   |   |  | Options exercisable             |                       |  |                              |
|--------------------------------|-----------------------|---|--|---------------------------------|-----------------------|--|------------------------------|
|                                | Number<br>outstanding | Weighted-<br>average<br>remaining<br>contractual life | Weighted-<br>average<br>exercise price | Aggregate<br>intrinsic<br>value | Number<br>exercisable | Weighted-<br>average<br>exercise price | Aggregate<br>intrinsic value |
| \$6.83                         | 1,025,190             | 7.3 years   | \$ 6.83                                | \$ 10,795                       | 597,867               | \$ 6.83                                | \$ 6,295                     |
| \$9.16 to \$9.44               | 37,625                | 7.5 years   | \$ 9.30                                | 303                             | 28,125                | \$ 9.30                                | 227                          |
| \$10.55 to \$11.65             | 123,325               | 7.9 years   | \$ 11.22                               | 757                             | 74,825                | \$ 11.26                               | 456                          |
| \$12.34 to \$13.37             | 1,074,600             | 9.0 years   | \$ 13.20                               | 4,474                           | 14,999                | \$ 12.43                               | 74                           |
| \$13.74 to \$16.33             | 393,425               | 9.0 years   | \$ 14.71                               | 1,042                           | 35,025                | \$ 14.34                               | 106                          |
| \$25.94                        | 140,000               | 9.9 years   | \$ 25.94                               |                                 |                       |  |                              |
|                                | 2,794,165             | 8.4 years   | \$ 11.57                               | \$ 17,371                       | 750,841               | \$ 7.83                                | \$ 7,158                     |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value based on the Company's closing stock price of \$17.36 as of December 31, 2005, that would have been received by the option holders had all option holders exercised their options as of that date. All options that were exercisable as of December 31, 2005 were in-the-money options.

Subsequent to December 31, 2005, the Company granted 250,000 options with an exercise price of \$16.00 to certain key employees. These options vest evenly over four years. On February 6, 2006, the Company also granted 3,900 shares of restricted stock, which vested immediately, to 39 employees as performance awards.

The Company maintains the Hudson Highland Group, Inc. Employee Stock Purchase Plan (the "ESPP"), pursuant to which eligible employees may purchase shares of the Company's common stock at the lesser of 85% of the fair market value at the commencement of each plan purchase period or 85% of the fair market value as of the purchase date. ESPP purchase dates are generally every six months ended June 30 and December 31, but for 2003 the dates were August 31 and December 31. In accordance with APB No. 25, the ESPP is a non-compensatory plan and no expenses were recorded for the ESPP. Pro-forma expenses included for SFAS 123 purposes were \$653, \$491 and \$402 for 2005, 2004 and 2003, respectively. The Company issued 164,930, 154,968 and 195,286 shares of common stock pursuant to the ESPP at an average price of \$12.71, \$10.26 and \$6.66 per share in 2005, 2004 and 2003, respectively. As of the December 31, 2005, the Company has 793,374 shares reserved for future share issuances under the ESPP and SIP (as defined below).

The Company's United Kingdom subsidiary maintains the Hudson Global Resources Share Incentive Plan (the "SIP"), a stock purchase plan for its employees, whereby eligible employees may purchase shares on the open market at the end of each month, and the Company matches the employee purchases with a contribution of shares equal to 50% of the number of employee shares purchased. The Company issued 2,653, 4,622 and 2,268 shares of common stock pursuant to the SIP in 2005, 2004 and 2003, respectively. Shares are issued under the SIP from the ESPP share reserve.

The Company maintains the Hudson Highland Group, Inc. 401(k) Savings Plan (the "401(k)"). The 401(k) plan allows eligible employees to contribute up to 15% of their earnings to the 401(k) plan. The Company matches contributions up to 3% and 2% for 2003 contributions, through a contribution of the Company's common stock. Vesting of the Company's contribution occurs over a five-year period. Expense for the years ended December 31, 2005, 2004 and 2003 for the 401(k) plan was \$2,071, \$1,607 and \$1,085, respectively. In March of 2005, the Company issued 94,960 shares of its common stock with a value of \$1,563 to satisfy the 2004



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

contribution liability to the 401(k) Savings Plan. In March of 2004, the Company issued 92,076 shares of its common stock with a value of \$1,058 to satisfy the 2003 contribution liability to the 401(k) Savings Plan. The 2005 401(k) plan matching shares will be issued in the first quarter of 2006.

**11. PROVISION (BENEFIT) FOR INCOME TAXES**

The tax provision in 2005 related primarily to the increase in foreign tax expense in jurisdictions where there were no tax-loss carry forwards available to offset taxable income. Income (loss) before provision for income taxes by domestic and foreign sources follows:

|  | Year ended December 31, |                    |                     |
|--|-------------------------|--------------------|---------------------|
|  | 2005                    | 2004               | 2003                |
| Domestic   | \$ (26,928)             | \$ (36,089)        | \$ (115,264)        |
| Foreign  | 37,277                  | 10,952             | (201,527)           |
| <b>Income (loss) before provision for income taxes</b> | <b>\$ 10,349</b>        | <b>\$ (25,137)</b> | <b>\$ (316,791)</b> |

The provision (benefit) for income taxes was as follows:

|   | Year ended December 31, |                 |                  |
|---|-------------------------|-----------------|------------------|
|   | 2005                    | 2004            | 2003             |
| <b>Current tax provision (benefit):</b> |                         |                 |                  |
| U.S. Federal                            | \$                      | \$ (1,288)      | \$               |
| State and local                         | 161                     | 690             | 36               |
| Foreign                                 | 3,854                   | 3,660           | 903              |
| <b>Total current</b>                    | <b>4,015</b>            | <b>3,062</b>    | <b>939</b>       |
| <b>Deferred tax provision (benefit)</b> |                         |                 |                  |
| U.S. Federal                            |                         |                 |                  |
| State and local                         |                         |                 |                  |
| Foreign                                 | 1,021                   | (1,424)         | 11,082           |
| <b>Total deferred</b>                   | <b>1,021</b>            | <b>(1,424)</b>  | <b>11,082</b>    |
| <b>Total provision</b>                  | <b>\$ 5,036</b>         | <b>\$ 1,638</b> | <b>\$ 12,021</b> |



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)**

The tax effects of temporary differences that gave rise to the Company's deferred tax assets (liabilities) were as follows:

|   | December 31,   |                 |
|---|----------------|-----------------|
|   | 2005           | 2004            |
| <b>Current deferred tax assets:</b>                   |                |                 |
| Allowance for doubtful accounts                       | \$ 944         | \$ 1,012        |
| Accrued expenses and other liabilities                | 1,726          | 3,456           |
| Accrued compensation liabilities                      | 3,226          | 4,549           |
| <b>Total current deferred tax asset</b>               | <b>5,896</b>   | <b>9,017</b>    |
| <b>Non-current deferred tax assets (liabilities):</b> |                |                 |
| Property and equipment                                | (1,618)        | (2,240)         |
| Intangibles   | 19,286         | 25,575          |
| Deferred compensation                                 | 586            | 446             |
| Tax loss carry-forwards                               | 99,800         | 95,400          |
| <b>Total non-current deferred tax asset</b>           | <b>118,054</b> | <b>119,181</b>  |
| Valuation allowance                                   | (123,226)      | (122,907)       |
| <b>Net deferred tax assets</b>                        | <b>\$ 724</b>  | <b>\$ 5,291</b> |

Net deferred tax assets were included in other current assets and other long-term assets. Through March 31, 2003, the Company was included in the United States Federal and certain state consolidated tax filings with Monster. The tax provisions and deferred tax assets and liabilities of the Company were calculated as if the Company were a separate entity.

At December 31, 2005, the Company had net operating loss carry-forwards for U.S. Federal tax purposes of approximately \$185,500, including approximately \$27,400 of tax losses that were not absorbed by Monster on its consolidated U.S. Federal tax returns through the Distribution Date, which expire through 2024. These losses included pre-acquisition losses of certain acquired companies and are subject to an annual limitation on the amount that can be utilized. In addition, the Company had net operating loss carry-forwards from all other countries of approximately \$86,200 at December 31, 2005. The Company has concluded that, based on expected future results and the future reversals of existing taxable temporary differences, there was no reasonable assurance that the entire amount related to tax benefits can be utilized. Accordingly, a valuation allowance was established.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(in thousands, except share and per share amounts)**

For the year ended December 31, 2005, the effective tax rate of 48.7% differs from the U.S. Federal statutory rate of 35% due largely to the inability to recognize tax benefits on net U.S. losses which include corporate expenses. Other factors also include valuation allowances on deferred tax assets related to net loss carry forwards, continuing losses in certain tax jurisdictions, variations from the U.S. tax rate in foreign jurisdictions, and certain non-deductible expenses such as meals and entertainment, amortization, business restructuring and spin off costs, and merger costs from pooling of interests transactions. The Company records a valuation allowance against deferred tax assets to the extent that it is more likely than not that some portion, or all of, the deferred tax assets will not be realized.

|  | Year ended December 31, |                 |                  |
|--|-------------------------|-----------------|------------------|
|  | 2005                    | 2004            | 2003             |
| Provision (benefit) at Federal statutory rate        | \$ 3,622                | \$ (8,798)      | \$ (110,877)     |
| State income taxes, net of Federal income tax effect | 161                     | 690             | 36               |
| Change in valuation allowance                        | 319                     | 25,614          | 43,269           |
| Nondeductible expenses                               | 634                     | 1,854           | 3,413            |
| Effect of foreign operations                         | 300                     | (16,434)        | 8,680            |
| Prior periods Federal income tax adjustment          |                         | (1,288)         |                  |
| Goodwill impairment                                  |                         |                 | 65,000           |
| Net operating losses retained/utilized by Monster    |                         |                 | 2,500            |
| <b>Income tax provision (benefit)</b>                | <b>\$ 5,036</b>         | <b>\$ 1,638</b> | <b>\$ 12,021</b> |

No provision was made for U.S. or additional foreign taxes on undistributed earnings of foreign subsidiaries. Such earnings have been and will continue to be reinvested but could become subject to additional tax if they were remitted as dividends, or were loaned to the Company or a U.S. affiliate, or if the Company should sell its stock in the foreign subsidiaries. It is not practicable to determine the amount of additional tax, if any, that might be payable on the undistributed foreign earnings. The provision for income taxes in 2003 included an \$11,082 expense for the increased valuation allowances established for deferred tax assets, whose future utilization was not reasonably assured, partially offset by higher deferred tax benefits from tax loss carry-forwards.

**12. COMMITMENTS AND CONTINGENCIES****Leases**

The Company leases facilities and equipment under operating leases that expire at various dates through 2027. Some of the operating leases provide for increasing rents over the terms of the leases; total rent expense under these leases is recognized ratably over the lease terms. Future minimum lease commitments under non-cancelable operating leases at December 31, 2005, were as follows:

|            |                   |
|------------|-------------------|
| 2006       | \$ 32,667         |
| 2007       | 27,452            |
| 2008       | 24,278            |
| 2009       | 20,637            |
| 2010       | 17,236            |
| Thereafter | 74,398            |
|            | <b>\$ 196,668</b> |



**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

Rent and related expenses under operating leases for facilities and equipment were \$31,425, \$31,912 and \$36,503 for the years ended December 31, 2005, 2004 and 2003, respectively. Operating lease obligations after 2009 relate to building leases. Commitments based in currencies other than U.S. dollars were translated using exchanges rates as of December 31, 2005.

**Consulting, Employment and Non-compete Agreements**

The Company has entered into various consulting, employment and non-compete agreements with certain key management personnel, executive search consultants and former owners of acquired businesses. Agreements with key members of management are generally one year in length, on an at will basis, and provide for compensation and severance payments under certain circumstances and are automatically renewed annually unless either party gives sufficient notice of termination. Agreements with certain consultants and former owners of acquired businesses are generally two to five years in length.

**Litigation**

The Company is subject to various claims from lawsuits, taxing authorities and other complaints arising in the ordinary course of business. The Company records provisions for losses when the claim becomes probable and the amount due is estimable. Although the outcome of these claims cannot be determined, it is the opinion of management that the final resolution of these matters will not have a material adverse effect on the Company's financial condition, results of operations, or liquidity.

**Risks and Uncertainties**

The Company has a history of operating losses and has operated as an independent company only since the Distribution Date. Prior to the Distribution Date, the Company's operations were historically financed by Monster as separate segments of Monster's broader corporate organization rather than as a separate stand-alone company. Monster assisted the Company by providing financing, particularly for acquisitions, as well as providing corporate functions such as identifying and negotiating acquisitions, legal and tax functions. Following the Distribution, Monster has no obligation to provide assistance to the Company other than the interim and transitional services provided by Monster pursuant to the transition services agreement described in Note 13.

**13. RELATED PARTY TRANSACTIONS**

**Distribution Business Agreements**

In connection with the Distribution, the Company and Monster entered into agreements covering employee benefit plans, real estate, transition services and tax separation.

The Company and Monster entered into various lease and sublease arrangements for the sharing of certain facilities for a transitional period on commercial terms. In the case of subleases or sub-subleases of property, the lease terms and conditions generally coincide with the remaining terms and conditions of the primary lease or sublease, respectively.

The Company entered into a transition services agreement with Monster effective as of the Distribution Date. Under the agreement, Monster provides to the Company, and the Company provides to Monster, certain insurance, tax, legal, facilities, human resources, information technology and other services that are required for a limited time (generally for one year following the Distribution Date, except as otherwise agreed).

---

**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

After the Distribution Date, the Company was no longer included in Monster's consolidated group for United States federal income tax purposes. The Company and Monster entered into a tax separation agreement to reflect the Company's separation from Monster with respect to tax matters. The primary purpose of the tax separation agreement is to reflect each party's rights and obligations relating to payments and refunds of taxes that are attributable to periods beginning before and including the date of the distribution and any taxes resulting from transactions effected in connection with the distribution. The Company has agreed to indemnify Monster for any tax liability attributable to the distribution resulting from any action taken by the Company.

**Monster Funding of HH Group Obligations**

Monster agreed at the Distribution Date to reimburse the Company for \$13,530 of cash payments related to the Company's accrued integration, restructuring and business reorganization obligations and other expenses during the first year following the spin-off. The Company has received payments of \$13,530 since the Distribution, and legal obligation for settlement of such liabilities remained with the Company.

**Other Commercial Arrangements**

The Company and Monster entered into a three-year commercial contract, which ends in March 2006, involving the utilization of Monster.com services for targeting, sourcing, screening and tracking prospective job candidates around the world. The Company and Monster may from time to time also negotiate and purchase other services from the other, pursuant to customary terms and conditions. There is no contractual commitment that requires the Company to use Monster services in preference to other competitors.

**Non-Cash Transfers**

Monster transferred to the Company non-cash assets and liabilities in 2003 prior to the Distribution Date. The approximate value recorded for the transfers by account were: due from Monster \$13,530, property and equipment \$7,600, intangibles \$1,500, accrued expenses and other current liabilities \$2,900, and other liabilities \$600.

**14. FINANCIAL INSTRUMENTS**

**Credit Facility**

The Company has a senior secured credit facility for \$75,000 (the Credit Facility). The maturity date of the Credit Facility is March 31, 2009. Outstanding loans will bear interest equal to the prime rate plus 0.25% or LIBOR plus 2.00%, at the Company's option and had a weighted average interest rate of 6.49% as of December 31, 2005. The Credit Facility is secured by substantially all of the assets of the Company and extensions of credit will be based on a percentage of the accounts receivable of the Company. The Company expects to continue to use such credit to support its ongoing working capital requirements, capital expenditures and other corporate purposes and to support letters of credit. As of December 31, 2005, the Company had outstanding borrowings of \$30,073 under the Credit Facility. As of December 31, 2004, the Company had no outstanding borrowings under the Credit Facility.

The Credit Facility contains various restrictions and covenants, including (1) prohibitions on payments of dividends and repurchases of the Company's stock; (2) requirements that the Company maintain its minimum Adjusted EBITDA (as defined in the Credit Facility) and capital expenditures within prescribed levels; (3) restrictions on the ability of the Company to make additional borrowings, or to consolidate, merge or

---

**Table of Contents**

**HUDSON HIGHLAND GROUP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share amounts)**

otherwise fundamentally change the ownership of the Company; and (4) limitations on investments, dispositions of assets and guarantees of indebtedness. On March 9, 2006, the Company entered into an amendment to the Credit Facility that established minimum Adjusted EBITDA measured on a trailing twelve-month basis and maximum capital expenditure covenant levels for fiscal year 2006. The minimum Adjusted EBITDA covenant generally provides that the Company's Adjusted EBITDA for the trailing twelve-month periods ending March 31, June 30, September 30 and December 31, 2006 may not be less than \$15,000, \$15,000, \$25,000 and \$25,000, respectively. The maximum capital expenditure covenant provides that the Company's capital expenditures for 2006 may not exceed \$14,000. These restrictions and covenants could limit the Company's ability to respond to market conditions, to provide for unanticipated capital investments, to raise additional debt or equity capital, to pay dividends or to take advantage of business opportunities, including future acquisitions.

**Outstanding Letters of Credit**

The Company had letters of credit outstanding at December 31, 2005 of \$15,502, leaving \$29,425 of the credit facility available for use on the terms set forth in the Credit Facility. These letters of credit have various maturity dates through 2015 and are primarily used to secure operating and capital lease financing and insurance coverage.

**Shelf Registration Statement Filing**

The Company filed a shelf registration in October 2004 to enable it to issue up to 1,350,000 shares of its common stock from time to time in connection with acquisitions of businesses, assets or securities of other companies, whether by purchase, merger or any other form of acquisition or business combination. If any shares are issued using this shelf registration, the Company will not receive any proceeds from these offerings other than the assets, businesses or securities acquired. As of December 31, 2005 all of the 1,350,000 shares are still available.

**Derivatives Held for Purposes Other Than Trading**

The Company periodically enters into forward contracts to minimize the exposure to foreign exchange rate risk related to intercompany loan balances denominated in currencies other than the functional currency. The fair values for all derivatives are recorded in other assets or other liabilities in the consolidated balance sheets. The Company had no outstanding derivatives as of December 31, 2005 and 2004.

**15. STOCKHOLDER RIGHTS PLAN**

On February 2, 2005, the Board of Directors of the Company declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock of the Company. The dividend was payable upon the close of business on February 28, 2005 to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value \$.001 par value (Preferred Shares), of the Company, at a price of \$60 per one one-hundredth of a Preferred Share, subject to adjustment. If any person becomes a 15% or more stockholder of the Company, then each Right (subject to certain limitations) will entitle its holder to purchase, at the Right's then current exercise price, a number of shares of common stock of the Company or of the acquirer having a market value at the time of twice the Right's per share exercise price. The Company's Board of Directors may redeem the Rights for \$.001 per Right at any time prior to the time when the Rights become exercisable. Unless the Rights are redeemed, exchanged or terminated earlier, they will expire on February 28, 2015.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**16. SEGMENT AND GEOGRAPHIC DATA**

The Company operates in four reportable segments: the three Hudson regional businesses of Hudson Americas, Hudson Europe and Hudson Asia Pacific, and Highland. The Company reassessed its reportable segments in the fourth quarter of 2005 and prior period results are presented in conformity with the 2005 presentation.

Segment information is presented in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. This standard is based on a management approach that requires segmentation based upon the Company's internal organization and disclosure of revenue, certain expenses and operating income based upon internal accounting methods. The Company's financial reporting systems present various data for management to run the business, including internal profit and loss statements prepared on a basis not consistent with generally accepted accounting principles. Accounts receivable, net and long-lived assets are the only significant assets separated by segment for internal reporting purposes.

| For the Year Ended  | Hudson     | Hudson     | Hudson       |           |             |              |
|---|------------|------------|--------------|-----------|-------------|--------------|
| December 31, 2005   | Americas   | Europe     | Asia Pacific | Highland  | Corporate   | Total        |
| Revenue   | \$ 446,949 | \$ 481,623 | \$ 436,877   | \$ 62,827 | \$          | \$ 1,428,276 |
| Gross margin  | \$ 114,414 | \$ 204,439 | \$ 158,345   | \$ 59,733 | \$          | \$ 536,931   |
| Business reorganization expenses (recoveries)                       | \$ 510     | \$ (42)    | \$ 43        | \$ (278)  | \$          | \$ 233       |
| EBITDA (loss)(a)  | \$ 13,910  | \$ 16,206  | \$ 30,555    | \$ 4,452  | \$ (35,539) | \$ 29,584    |
| Depreciation and amortization                                       | 5,217      | 4,771      | 6,501        | 1,354     | 569         | 18,412       |
| Operating income (loss)   | 8,693      | 11,435     | 24,054       | 3,098     | (36,108)    | 11,172       |
| Interest and other income (expense), net                            | (232)      | 2,331      | 194          | 1,841     | (4,957)     | (823)        |
| Income (loss) before income taxes                                   | \$ 8,461   | \$ 13,766  | \$ 24,248    | \$ 4,939  | \$ (41,065) | \$ 10,349    |
| <b>As of December 31, 2005</b>                                      |            |            |              |           |             |              |
| Accounts receivable, net  | \$ 89,078  | \$ 87,547  | \$ 45,430    | \$ 10,026 | \$          | \$ 232,081   |
| Long-lived assets, net of accumulated depreciation and amortization | \$ 17,096  | \$ 31,387  | \$ 6,668     | \$ 1,464  | \$ 5,923    | \$ 62,538    |
| For the Year Ended  | Hudson     | Hudson     | Hudson       |           |             |              |
| December 31, 2004   | Americas   | Europe     | Asia Pacific | Highland  | Corporate   | Total        |
| Revenue   | \$ 334,765 | \$ 447,483 | \$ 412,427   | \$ 61,679 | \$          | \$ 1,256,354 |
| Gross margin  | \$ 86,662  | \$ 182,069 | \$ 143,360   | \$ 58,129 | \$          | \$ 470,220   |
| Business reorganization expenses (recoveries)                       | \$ 1,051   | \$ 225     | \$ (260)     | \$ 2,345  | \$          | \$ 3,361     |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|   |            |            |           |            |             |             |
|---|------------|------------|-----------|------------|-------------|-------------|
| EBITDA (loss)(a)  | \$ 4,343   | \$ 297     | \$ 23,811 | \$ (69)    | \$ (31,473) | \$ (3,091)  |
| Depreciation and amortization                                       | 5,307      | 4,773      | 6,163     | 1,805      | 2,060       | 20,108      |
| Operating income (loss)   | (964)      | (4,476)    | 17,648    | (1,874)    | (33,533)    | (23,199)    |
| Interest and other income (expense), net                            | (150)      | 2,978      | (122)     | 119        | (4,763)     | (1,938)     |
| Income (loss) before income taxes                                   | \$ (1,114) | \$ (1,498) | \$ 17,526 | \$ (1,755) | \$ (38,296) | \$ (25,137) |
| <b><i>As of December 31, 2004</i></b>                               |            |            |           |            |             |             |
| Accounts receivable, net  | \$ 52,931  | \$ 83,739  | \$ 52,747 | \$ 8,165   | \$          | \$ 197,582  |
| Long-lived assets, net of accumulated depreciation and amortization | \$ 13,944  | \$ 8,442   | \$ 11,689 | \$ 2,347   | \$ 6,042    | \$ 42,464   |



**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

| For the Year Ended  | Hudson      | Hudson       | Hudson       |             |             |              |
|---|-------------|--------------|--------------|-------------|-------------|--------------|
| December 31, 2003   | Americas    | Europe       | Asia Pacific | Highland    | Corporate   | Total        |
| Revenue   | \$ 278,935  | \$ 364,766   | \$ 377,555   | \$ 64,043   | \$          | \$ 1,085,299 |
| Gross margin  | \$ 65,220   | \$ 154,632   | \$ 122,840   | \$ 60,337   | \$          | \$ 403,029   |
| Goodwill impairment   | \$ 55,351   | \$ 128,707   | \$ 11,346    | \$ 7,381    | \$          | \$ 202,785   |
| Business reorganization expenses                                    | \$ 1,874    | \$ 9,536     | \$ 4,366     | \$ 10,829   | \$ 218      | \$ 26,823    |
| EBITDA (loss)(a)  | \$ (69,468) | \$ (154,141) | \$ (8,975)   | \$ (30,722) | \$ (29,044) | \$ (292,350) |
| Depreciation and amortization                                       | 3,988       | 4,373        | 5,710        | 4,234       | 2,994       | 21,299       |
| Operating loss  | (73,456)    | (158,514)    | (14,685)     | (34,956)    | (32,038)    | (313,649)    |
| Interest and other income (expense), net                            | (586)       | (1,099)      | 794          | (965)       | (1,286)     | (3,142)      |
| Loss before income taxes  | \$ (74,042) | \$ (159,613) | \$ (13,891)  | \$ (35,921) | \$ (33,324) | \$ (316,791) |
| <i>As of December 31, 2003</i>                                      |             |              |              |             |             |              |
| Accounts receivable, net  | \$ 36,607   | \$ 61,184    | \$ 41,797    | \$ 9,454    | \$          | \$ 149,042   |
| Long-lived assets, net of accumulated depreciation and amortization | \$ 8,702    | \$ 10,254    | \$ 10,948    | \$ 3,996    | \$ 6,905    | \$ 40,805    |

(a) Non-GAAP earnings before interest, income taxes, other non-operating expense, and depreciation and amortization ( EBITDA ) are presented to provide additional information to investors about the Company's operations on a basis consistent with the measures which the Company uses to manage its operations and evaluate its performance. Management also uses this measurement to evaluate capital needs and working capital requirements. EBITDA should not be considered in isolation or as a substitute for operating income, cash flows from operating activities, and other income or cash flow statement data prepared in accordance with generally accepted accounting principles or as a measure of the Company's profitability or liquidity. Furthermore, EBITDA as presented above may not be comparable with similarly titled measure reported by other companies.

| Information by geographic region  | United States | Australia  | United Kingdom | Continental Europe | Other Asia | Other Americas | Total        |
|---|---------------|------------|----------------|--------------------|------------|----------------|--------------|
| <b>Year ended December 31, 2005:</b>                                    |               |            |                |                    |            |                |              |
| Revenue (b)   | \$ 488,037    | \$ 336,687 | \$ 373,752     | \$ 119,020         | \$ 104,074 | \$ 6,706       | \$ 1,428,276 |
| Long-lived assets, net of accumulated depreciation and amortization (c) | \$ 23,691     | \$ 6,073   | \$ 4,369       | \$ 27,450          | \$ 713     | \$ 242         | \$ 62,538    |
| <b>Year ended December 31, 2004:</b>                                    |               |            |                |                    |            |                |              |
| Revenue (b)   | \$ 373,329    | \$ 332,029 | \$ 352,563     | \$ 102,371         | \$ 89,710  | \$ 6,352       | \$ 1,256,354 |

Edgar Filing: HUDSON HIGHLAND GROUP INC - Form 10-K

|   |           |          |          |          |          |        |           |
|---|-----------|----------|----------|----------|----------|--------|-----------|
| Long-lived assets, net of accumulated depreciation and amortization (c) | \$ 21,287 | \$ 9,970 | \$ 5,836 | \$ 3,417 | \$ 1,720 | \$ 234 | \$ 42,464 |
|---|-----------|----------|----------|----------|----------|--------|-----------|

**Year ended December 31, 2003:**

|             |            |            |            |           |           |          |              |
|-------------|------------|------------|------------|-----------|-----------|----------|--------------|
| Revenue (b) | \$ 317,595 | \$ 310,525 | \$ 282,075 | \$ 97,794 | \$ 71,864 | \$ 5,446 | \$ 1,085,299 |
|-------------|------------|------------|------------|-----------|-----------|----------|--------------|

|   |           |          |          |          |          |        |           |
|---|-----------|----------|----------|----------|----------|--------|-----------|
| Long-lived assets, net of accumulated depreciation and amortization (c) | \$ 17,869 | \$ 8,843 | \$ 7,282 | \$ 4,202 | \$ 2,110 | \$ 499 | \$ 40,805 |
|---|-----------|----------|----------|----------|----------|--------|-----------|

(b) Revenue is generally recorded on a geographic basis according to the location of the operating subsidiary.

(c) Comprised of property and equipment and intangibles. Corporate assets are included in the United States.

**Table of Contents****HUDSON HIGHLAND GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share amounts)

**17. SELECTED QUARTERLY FINANCIAL DATA (unaudited)**

|   | First quarter | Second quarter | Third quarter | Fourth quarter |
|---|---------------|----------------|---------------|----------------|
| <b>Year ended December 31, 2005:</b>                        |               |                |               |                |
| Revenue   | \$ 352,869    | \$ 364,835     | \$ 356,603    | \$ 353,969     |
| Gross margin  | \$ 128,207    | \$ 141,167     | \$ 135,168    | \$ 132,389     |
| Operating income (loss)                                     | \$ (2,035)    | \$ 6,355       | \$ 4,439      | \$ 2,413       |
| Net income (loss)   | \$ (4,137)    | \$ 4,365       | \$ 2,295      | \$ 2,790       |
| Basic earnings (loss) per share                             | \$ (0.20)     | \$ 0.21        | \$ 0.10       | \$ 0.12        |
| Diluted earnings (loss) per share (a)                       | \$ (0.20)     | \$ 0.20        | \$ 0.09       | \$ 0.11        |
| Basic weighted average shares outstanding for quarter (b)   | 20,504,000    | 20,642,000     | 23,875,000    | 24,103,000     |
| Diluted weighted average shares outstanding for quarter (b) | 20,504,000    | 21,635,000     | 25,540,000    | 25,823,000     |

|   | First quarter | Second quarter | Third quarter | Fourth quarter |
|---|---------------|----------------|---------------|----------------|
| <b>Year ended December 31, 2004:</b>                        |               |                |               |                |
| Revenue   | \$ 289,804    | \$ 307,431     | \$ 315,029    | \$ 344,090     |
| Gross margin  | \$ 106,391    | \$ 118,489     | \$ 116,414    | \$ 128,926     |
| Operating income (loss)                                     | \$ (16,307)   | \$ 680         | \$ (6,748)    | \$ (824)       |
| Net income (loss)   | \$ (18,708)   | \$ 217         | \$ (6,947)    | \$ (1,337)     |
| Basic earnings (loss) per share                             | \$ (1.09)     | \$ 0.01        | \$ (0.34)     | \$ (0.07)      |
| Diluted earnings (loss) per share (a)                       | \$ (1.09)     | \$ 0.01        | \$ (0.34)     | \$ (0.07)      |
| Basic weighted average shares outstanding for quarter (b)   | 17,231,000    | 19,901,000     | 20,306,000    | 20,371,000     |
| Diluted weighted average shares outstanding for quarter (b) | 17,231,000    | 20,872,000     | 20,306,000    | 20,371,000     |

(a) Diluted earnings (loss) per share reflect the potential dilution from the assumed exercise of all dilutive potential common shares, primarily stock options. For the first quarter in 2005 and the first, third and fourth quarters in 2004, the effect of approximately 1,138,000, 1,000,000, 918,000 and 830,000, respectively, of outstanding stock options and other common stock equivalents was excluded from the calculation of diluted loss per share because the effect was anti-dilutive.

(b) Weighted average shares outstanding increased primarily due to the Company's issuances of 3,223,640 shares of common stock in a registered public offering on July 6, 2005, 2,547,770 shares of common stock in a registered public offering on March 23, 2004, and of 367,174 shares of common stock to purchase a business on June 2, 2004.

Earnings (loss) per share calculations for each quarter include the weighted average effect for the quarter; therefore, the sum of quarterly loss per share amounts may not equal year-to-date loss per share amounts, which reflect the weighted average effect on a year-to-date basis.

**Table of Contents**

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's Chairman and Chief Executive Officer and its Executive Vice President and Chief Financial Officer, has conducted an evaluation of the design and operation of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, the Company's Chairman and Chief Executive Officer and its Executive Vice President and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this Annual Report on Form 10-K.

**Management's Annual Report on Internal Control Over Financial Reporting**

The report of management required under this Item 9A is contained in Item 8 of this Annual Report on Form 10-K under the caption Management's Annual Report on Internal Control Over Financial Reporting on page 31.

**Report of Independent Registered Public Accounting Firm**

The attestation report under this Item 9A is contained in Item 8 of this Annual Report on Form 10-K under the caption Report of Independent Registered Public Accounting Firm on page 32.

**Changes in Internal Control Over Financial Reporting**

During the third quarter of 2005, the Company implemented a new accounting and management reporting system in its Hudson North America business. As a result of this activity, the Company experienced a delay in its ability to produce management reports and customer invoices in a timely manner within the Hudson North America division for a period of time within the quarter. The December 31, 2005 balance sheet reflects a related increase in billed and unbilled receivables, and the results of operations reflect a corresponding increase in the use of cash.

The Company has taken a number of additional steps to ensure that the financial statements included in this report accurately reflect the financial position of the Company and the results of operations for the periods indicated. These procedures have included, but were not limited to: applying additional methods and techniques to evaluate the accuracy of the revenue and unbilled revenue accounts; ensuring that additional control procedures, such as manual checks and balances, reconciliations, instituting changes in process, and additional training were put in place; and implementing increased monitoring of operating cash flow in recognition of the expected slowing of cash receipts resulting from delayed billings.

Other than the aforementioned change in the Hudson North American systems, there were no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company is continuing to implement the accounting and management reporting system in its Hudson North America business, and in that process, expects that there will be future changes in internal controls as a result of this implementation.

**Table of Contents**

**ITEM 9B. OTHER INFORMATION**

***Entry into a Material Definitive Agreement***

On March 9, 2006, the Company entered into an amendment (the "Amendment") to its Amended and Restated Loan and Security Agreement, dated as of June 25, 2003 (the "Loan Agreement"), to establish the minimum Adjusted EBITDA (as defined in the Loan Agreement) thresholds measured on a trailing twelve-month basis and the maximum capital expenditures allowed under the Loan Agreement covenants for the Company in 2006. The minimum Adjusted EBITDA covenant generally provides that the Company's minimum Adjusted EBITDA for the trailing twelve-month periods ending March 31, June 30, September 30 and December 31, 2006 may not be less than \$15,000, \$15,000, \$25,000 and \$25,000, respectively. The maximum capital expenditure covenant provides that the Company's capital expenditures for 2006 may not exceed \$14,000. The Amendment is filed as Exhibit 4.9 to this Annual Report on Form 10-K and is incorporated herein by reference.

**Table of Contents****PART III****ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Pursuant to Instruction G(3) to Form 10-K, the information included under the captions Election of Directors, Board of Directors and Corporate Governance and Section 16(a) Beneficial Ownership Reporting Compliance in the Company's definitive proxy statement, which is expected to be filed pursuant to Regulation 14A within 120 days following the end of the fiscal year covered by this report (the Proxy Statement), is hereby incorporated by reference. The information required by Item 10 with respect to our Executive Officers is included in Part I of this Annual Report on Form 10-K.

We have adopted a Code of Business Conduct and Ethics that applies to all of our employees and a Code of Ethics for the Chief Executive Officer and the Senior Financial and Accounting Officers. We have posted a copy of the Code of Business Conduct and Ethics and the Code of Ethics on our Web site at www.hhgroup.com. The Code of Business Conduct and Ethics and Code of Ethics are also available in print to any stockholder who requests them in writing from the Corporate Secretary at 622 Third Avenue, New York, New York 10017. We intend to satisfy the disclosure requirements under Item 5.05 of Form 8-K regarding amendments to, or waivers from, our Code of Ethics by posting such information on our Web site at www.hhgroup.com. We are not including the information contained on our Web site as part of, or incorporating it by reference into, this report.

**ITEM 11. EXECUTIVE COMPENSATION**

Pursuant to Instruction G(3) to Form 10-K, the information required in Item 11 is incorporated by reference to the Proxy Statement under the captions Board of Directors and Corporate Governance Director Compensation and Executive Compensation.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

Pursuant to Instruction G(3) to Form 10-K, the information required in Item 12 is incorporated by reference to the Proxy Statement under the caption Principal Stockholders.

**Equity Compensation Plan Information**

The following table presents information on the Company's existing equity incentive plans as of December 31, 2005.

|   | Number of shares to<br>be issued upon exercise of<br>outstanding<br>options<br>A | Weighted average<br>exercise<br>price of outstanding<br>options<br>B | Number of shares remaining<br>available for future issuance<br>under equity compensation plans<br>(excluding shares reflected in<br>Column A)(1)<br>C |
|---|--|--|---|
| Equity Compensation Plans approved by stockholders:     |  |  |   |
| Long Term Incentive Plan                                | 2,794,165  | \$ 11.57   | 976,686   |
| Employee Stock Purchase Plan                            |  |  | 793,374   |
| Equity Compensation Plans not approved by stockholders: |  |  |   |
| Total   | 2,794,165  | \$ 11.57   | 1,770,242   |

(1) Excludes 25,750 shares of restricted common stock vesting over a three-year retention period and 112,500 shares of restricted common stock vesting over a four-year vesting period, previously issued under the Hudson Highland Group, Inc. Long Term Incentive Plan.



---

**Table of Contents**

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Not applicable.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Pursuant to Instruction G(3) to Form 10-K, the information required in Item 14 is incorporated by reference to the Proxy Statement under the caption Ratification of the Appointment of BDO Seidman, LLP as Independent Registered Public Accountants.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENTS SCHEDULES**

(a) 1. Financial statements The following financial statements and the report of independent registered public accounting firm are contained in Item 8.

|  | <b>Page</b> |
|--|-------------|
| <u>Reports of Independent Registered Public Accounting Firm</u>  | 33          |
| <u>Consolidated Statements of Operations for the Years Ended December 31, 2005, 2004 and 2003</u>                      | 35          |
| <u>Consolidated Balance Sheets as of December 31, 2005 and 2004</u>  | 36          |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003</u>                      | 37          |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2005, 2004 and 2003</u> | 38          |
| <u>Notes to Consolidated Financial Statements</u>  | 39          |

2. Financial statement schedules

Schedule II Valuation and qualifying accounts and reserves.

All other schedules are omitted since the required information is not present, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and the notes thereto.

3. Exhibits The exhibits listed in the accompanying index to exhibits are filed as part of this Annual Report on Form 10-K.



**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors

Hudson Highland Group, Inc.

New York, New York

The audits referred to in our report dated March 10, 2006, relating to the consolidated financial statements of Hudson Highland Group, Inc., which is contained in Item 8 of this Form 10-K, included the audits of the consolidated financial statement schedule listed in the accompanying index. This consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statement schedule based upon our audits.

In our opinion, the consolidated financial statement schedule presents fairly, in all material respects, the information set forth therein.

/s/ BDO SEIDMAN, LLP  
BDO Seidman, LLP

New York, New York

March 10, 2006

**Table of Contents****SCHEDULE II****VALUATION AND QUALIFYING ACCOUNTS****(IN THOUSANDS)**

| Column A                        | Column B                             | Column C Additions                           |                                 | Column D   | Column E                       |
|---------------------------------|--------------------------------------|--|---------------------------------|------------|--------------------------------|
| Descriptions                    | Balance at<br>Beginning<br>of Period | Charged to<br>Costs/Expenses<br>(Recoveries) | Charged to<br>Other<br>Accounts | Deductions | Balance at<br>End<br>of Period |
| Allowance for Doubtful Accounts |                                      |  |                                 |            |                                |
| Year ended December 31, 2003    | \$ 10,281                            | 13,482                                       |                                 | 17,360     | \$ 6,403                       |
| Year ended December 31, 2004    | \$ 6,403                             | (683)  |                                 | 490        | \$ 5,230                       |
| Year ended December 31, 2005    | \$ 5,230                             | 2,233  |                                 | 1,975      | \$ 5,488                       |

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this Fifteenth of March 2006.

HUDSON HIGHLAND GROUP, INC.

By */s/* JON F. CHAIT  
**Jon F. Chait**

**Chairman and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <b>Signature</b>   | <b>Title</b>  | <b>Date</b>    |
|--|---|----------------|
| <i>/s/</i> JON F. CHAIT<br><b>Jon F. Chait</b>             | Chairman and Chief Executive Officer and Director<br>(Principal Executive Officer)    | March 15, 2006 |
| <i>/s/</i> MARY JANE RAYMOND<br><b>Mary Jane Raymond</b>   | Executive Vice President and Chief Financial<br>Officer (Principal Financial Officer) | March 15, 2006 |
| <i>/s/</i> RALPH L. O HARA<br><b>Ralph L. O Hara</b>       | Vice President, Global Controller (Principal<br>Accounting Officer)                   | March 15, 2006 |
| <i>/s/</i> JOHN J. HALEY<br><b>John J. Haley</b>           | Director  | March 15, 2006 |
| <i>/s/</i> JENNIFER LAING<br><b>Jennifer Laing</b>         | Director  | March 15, 2006 |
| <i>/s/</i> NICHOLAS G. MOORE<br><b>Nicholas G. Moore</b>   | Director  | March 15, 2006 |
| <i>/s/</i> DAVID G. OFFENSEND<br><b>David G. Offensend</b> | Director  | March 15, 2006 |
| <i>/s/</i> RENÉ SCHUSTER<br><b>René Schuster</b>           | Director  | March 15, 2006 |

**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>  |
|-----------------------|---|
| (3.1)                 | Amended and Restated Certificate of Incorporation of Hudson Highland Group, Inc. (incorporated by reference to Exhibit 3.1 to Hudson Highland Group, Inc.'s Registration Statement on Form 10 filed March 14, 2003 (file No. 0-50129)).   |
| (3.2)                 | Certificate of Designations of the Board of Directors Establishing the Series and Fixing the Relative Rights and Preferences of Series A Junior Participating Preferred Stock. (incorporated by reference to Exhibit 3.1 to Hudson Highland Group, Inc.'s Current Report on Form 8-K dated February 2, 2005 (file No. 0-50129)).  |
| (3.3)                 | Amended and Restated By-laws of Hudson Highland Group, Inc. (incorporated by reference to Exhibit 3.1 to Hudson Highland Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004 (file No. 0-50129)).  |
| (4.1)                 | Amended Restated Loan and Security Agreement, dated as of June 25, 2003, by and among the Registrant and each of its subsidiaries that are signatories thereto, as Borrowers, the lenders that are signatories thereto, as the Lenders, and Wells Fargo Foothill, Inc. as the Arranger and Administrative Agent (incorporated by reference to Exhibit 4.1 to Hudson Highland Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (file No. 0-50129)). |
| (4.2)                 | Amendment No. 1 to Amended and Restated Loan Security Agreement, dated as of September 30, 2003, between the Registrant and Wells Fargo Foothill, Inc. (incorporated by reference to Exhibit 4 to Hudson Highland Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 (file No. 0-50129)).   |
| (4.3)                 | Amendment No. 2 to and Consent Under Amended and Restated Loan and Security Agreement, dated as of December 29, 2003, between the Registrant and Wells Fargo Foothill, Inc. (incorporated by reference to Exhibit 4 to Hudson Highland Group, Inc.'s Current Report on Form 8-K dated January 15, 2004 (file No. 0-50129)).   |
| (4.4)                 | Amendment No. 3, Consent and Joinder to Amended and Restated Loan Security Agreement, Dated March 2, 2004, between Hudson Highland Group, Inc. and Wells Fargo Foothill, Inc. (incorporated by reference to Exhibit 4.3 to Hudson Highland Group, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2003 (file No. 0-50129)).   |
| (4.5)                 | Amendment No. 4, Consent and Joinder to Amended and Restated Loan and Security Agreement, dated as of July 27, 2004, among Hudson Highland Group, Inc., the Borrowers (as defined therein), the Joining Guarantors (as defined therein), Wells Fargo Foothill, Inc. and the lenders identified therein (incorporated by reference to Exhibit 4 to Hudson Highland Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 (file No. 0-50129)).            |
| (4.6)                 | Amendment No. 5 to Amended and Restated Loan and Security Agreement, dated as of March 31, 2005, by and among Hudson Highland Group, Inc., the Borrowers (as defined therein), Wells Fargo Foothill, Inc. and the Lenders (as defined therein) (incorporated by reference to Exhibit 4.1 to Hudson Highland Group, Inc.'s Current Report on Form 8-K dated March 31, 2005 (file No. 0-50129)).  |
| (4.7)                 | Amendment No. 6 to Amended Loan and Restated Loan and Security Agreement, dated as of May 2, 2005, among Hudson Highland Group, Inc., the Borrowers (as defined therein), Wells Fargo Foothill, Inc. and the Lenders (as defined therein) (incorporated by reference to Exhibit 4.1 to Hudson Highland Group, Inc.'s Form 8-K dated May 2, 2005 (file No. 0-50129)).  |
| (4.8)                 | Amendment No. 8 to Amended and Restated Loan and Security Agreement, dated as of June 8, 2005, by and among Hudson Highland Group, Inc., the Borrowers (as defined therein), Wells Fargo Foothill, Inc. and the Lenders (as defined therein) (incorporated by reference to Exhibit 4.1 to Hudson Highland Group, Inc.'s Form 8-K dated June 8, 2005 (file No. 0-50129)).  |

**Table of Contents**

| <b>Exhibit<br/>Number</b> | <b>Exhibit Description</b>  |
|---------------------------|---|
| (4.9)                     | Amendment No. 9 to Amended and Restated Loan and Security Agreement, dated as of March 9, 2006, by and among Hudson Highland Group, Inc., the Borrowers (as defined therein), Wells Fargo Foothill, Inc. and the Lenders (as defined therein).  |
| (4.10)                    | Rights Agreement, dated as of February 2, 2005, between Hudson Highland Group, Inc. and The Bank of New York (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form 8-A of Hudson Highland Group, Inc. February 3, 2005 (file No. 0-50129)).   |
| (10.1)*                   | Hudson Highland Group, Inc. Long Term Incentive Plan, as amended through February 2, 2005 (incorporated by reference to Annex A to the Hudson Highland Group, Inc. s proxy statement for its 2005 annual meeting of shareholders filed with the SEC on March 28, 2005 (file No. 0-50129)).  |
| (10.2)*                   | Form of Hudson Highland Group, Inc. Stock Option Agreement (Directors) (incorporated by reference to Exhibit 10.5 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)).  |
| (10.3)*                   | Form of Hudson Highland Group, Inc. Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.6 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)).  |
| (10.4)*                   | Form of Hudson Highland Group, Inc. Stock Option Agreement (Employees) (incorporated by reference to Exhibit 10.4 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)).  |
| (10.5)*                   | Executive Excise Tax Gross-Up Agreement, effective as of May 6, 2005, between Hudson Highland Group, Inc. and Jon F. Chait (incorporated by reference to Exhibit 10.3 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)).  |
| (10.6)*                   | Form of Hudson Highland Group Executive Employment Agreement, effective as of May 6, 2005, between Hudson Highland Group, Inc. and each of Margaretta Noonan, Richard S. Gray, Richard A. Harris, Neil J. Funk, Ralph L. O Hara and Latham Williams (incorporated by reference to Exhibit 10.2 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)). |
| (10.7)*                   | Executive Agreement, dated June 14, 2005, between Hudson Highland Group, Inc. and Richard W. Pehlke (incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc. s Form 8-K dated June 9, 2005 (file No. 0-50129)).  |
| (10.8)*                   | Hudson Highland Group Executive Employment Agreement, effective as of June 1, 2005, between Hudson Highland Group, Inc. and Elaine A. Kloss (incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc. s Form 8-K dated June 1, 2005 (file No. 0-50129)).  |
| (10.9)*                   | Executive Employment Agreement, effective as of December 1, 2005, between Hudson Highland Group, Inc. and Mary Jane Raymond (incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc. s Form 8-K dated October 26, 2005 (file No. 0-50129)).  |
| (10.10)*                  | Executive Employment Agreement, effective as of December 31, 2005, between Hudson Highland Group, Inc. and Don Bielinski. (Incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc. s Form 8-K dated March 14, 2006 (File No. 0-50129)).  |
| (10.11)*                  | Hudson Highland Group, Inc. 2004 Nonqualified Deferred Compensation Plan (as Amended and Restated Effective January 1, 2005) (incorporated by reference to Exhibit 10.7 to Hudson Highland Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (file No. 0-50129)).  |
| (10.12)*                  | Summary of Hudson Highland Group, Inc. Compensation for Non-employee Members of the Board of Directors (incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc. s Form 8-K dated July 12, 2005 (File No. 0-50129)).  |

**Table of Contents**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>   |
|-----------------------|--|
| (10.13)*              | Summary of Hudson Highland Group, Inc. 2005 Incentive Compensation Program (incorporated by reference to Exhibit 10.1 to Hudson Highland Group, Inc.'s Current Report on Form 8-K dated February 15, 2006 (file No. 0-50129)).   |
| (21)                  | Subsidiaries of Hudson Highland Group, Inc.  |
| (23)                  | Consent of BDO Seidman, LLP.   |
| (31.1)                | Certification by Chairman and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.   |
| (31.2)                | Certification by the Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.   |
| (32.1)                | Certification of the Chairman and Chief Executive Officer pursuant to 18 U.S.C. Section 1350.  |
| (32.2)                | Certification of the Executive Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.  |
| (99.1)                | Proxy Statement for the 2006 Annual Meeting of Stockholders [To be filed with the Securities and Exchange Commission under Regulation 14A within 120 days after December 31, 2005; except to the extent specifically incorporated by reference, the Proxy Statement for the 2006 Annual Meeting of Stockholders shall not be deemed to be filed with the Securities and Exchange Commission as part of this Annual Report on Form 10-K.] |

---

\* A management contract or compensatory plan or arrangement.