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Conference Call Transcript

HHGP - Hudson Highland Group, Inc Guidance Announcement

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PRESENTATION

Operator

Good afternoon. My name is Jeremy, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Hudson Highland Group Conference Call. All lines have been placed on mute, to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *,then the number 1 on your telephone keypad. If you would like to withdraw your question, press *, then the number 2 on your telephone keypad. Thank you.

Mr. Kirby, you may begin your conference.

David Kirby - ***Hudson Highland Group - Director IR***

Thank you, Operator. Thank you all for joining us, today. On the call today, we will have Jon Chait, Chairman and CEO,Mary Jane Raymond, EVP and CFO, Richard W. Pelhke, EVP – and myself, David Kirby, Director IR.

Before we begin, I will read the Safe Harbor Statement. Please be advised that except for historical information, statements made during our presentation may constitute forward-looking statements, under applicable Securities laws. Such forward-looking statements involve certain risks and uncertainties – including statements regarding the Company's strategic direction, prospects and future results.

Certain factors – including factors outside of our control, may cause actual results to differ materially from those contained in the forward-looking statements -- including economic and other conditions in the markets in which we operate, risks associated with acquisitions, competition, seasonality and the other risks discussed in our filings made with the SEC.

These forward-looking statements speak only as of today. The Company assumes no obligation and expressly disclaims any obligation to review or confirm analysts' expectations or estimates, or to update any forward-looking statements – whether as a result of new information, future events or otherwise.

With that, I will turn the call over to Jon Chait.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thank you very much, David. Thank you all for joining us today. I'd like to open the call by just welcoming Mary Jane Raymond to the company. She's been an employee for about 22 days, and is certainly having a very interesting first month of her employment.

Turning to the announcement today, I wanted to reassure you that I am very disappointed to have to make today's announcement – reducing our guidance for 2005 – from a range of 30-34 million, to a revised range of 27-30 million. I want to reassure you that nothing I say today should in any way minimize the seriousness with which I view the press release that we put out today.

Certainly, the 4th quarter is not going to be what we expected when we issued our guidance about 8 weeks ago. But I believe it does not reflect anything fundamentally wrong with our business model, or any change in our long-term goal of building sustainable profitability in our business, and reaching a level of profitability measured by EBITDA as a percent of revenue of 7-10 percent in normalized conditions.

I want to remind you that virtually since I joined the company, we have always pointed out the operating leverage inherent in our business – as well as the low visibility inherent in the large proportion of our business – which is attributable to permanent recruitment.

For much of this year and much of the last 2.5 years, that leverage has worked to our advantage. Unfortunately, in this quarter, it is distinctly working to our disadvantage. But again, I do not believe that this reflects anything fundamentally wrong with our business model. In our current state of regeneration of our company, small changes in gross margin percentages and dollars equal large changes in EBITDA. That's simply a fact of where we are in our recovery cycle as a company.

Turning to the press release – I want to walk through the issues that we discussed in the press release, and provide you with some additional color, I hope, on those issues. First of all, let me clarify one question that a number of people have raised with us. That is, in the press release, we mentioned that in our Australia/New Zealand business, which we usually refer to as ANZ – or sometimes, inevitably, AN Zed – which is the Australian pronunciation – that gross margin had been running at a level that was up 4.5 percent in the first 9 months. We meant that to refer to gross margin dollars – rather than the gross margin percentage.

Some of you have pointed out that means gross profit, in some people's vocabulary. I'm sorry for the confusion. But the fundamental is that when we built our guidance, we had assumed that we would continue running roughly at the rate that we had run at for the previous 9 months in the ANZ economy – which was up 4.5 percent in gross margin dollars in local currency. Whereas, in fact, in October and November, we had run – as the press release says – at a level which is down 1.6 percent.

So turning now to the issues that are generating that reduction in gross margin. Certainly, the largest issue with respect to that is a hiring freeze related to specific customers in that market. Let me put that in context for you, first of all.

In ANZ, we operate a business which is distinctly different from the other Hudson Highland Group markets. That is, it's a wonderful business. We have a very large market share in that market. In the professional services arena, we believe we're by far the largest player in the market. Roughly 50 percent of our business in that market is devoted to what we call PSA relationships, or Preferred Supplier Agreements.

As a result, we have some large contracts with the largest commercial enterprises and governmental institutions in the market. Of course, because they're large accounts, sometimes changes in large accounts can have an immediate impact on our business.

In this particular case, several customers have instituted hiring freezes in the 4th quarter. To our belief, these are customer-specific actions. We will not get into naming the particular customers, today. But I can assure you that these are large, well-known, highly-regarded ANZ entities. It does not, in our opinion, in any way reflect on our relationship on an ongoing basis, with these customers. We continue to do business with them in other categories of business, outside of permanent recruitment. The hiring freezes have been affected largely in permanent recruitment.

The issue with permanent recruitment is that it has a very immediate impact on our profitability, because permanent recruitment is inherently more profitable than temporary recruitment, and it hits quite immediately. That's the origin of the problem in that market.

As I said, we don't think that this impacts on our relationships with those customers, because we continue to provide those customers with temporary services. And we also continue to provide a number of those customers with consulting services as well.

We're not economists. We are conscious, however, that the ANZ economies have had very long runs of positive economic growth. More than 10 years in each case. We are not economists. However, we have seen no evidence that this is indicative in any way of an economic downturn.

We are somewhat comforted, if you can say that in this kind of a situation. We are somewhat comforted by the fact that these are societies that are experiencing extreme skill shortages. Meaning that there is an excess demand over supply in the societies as a whole.

My experience – and I can only look back to my experience of being in this industry – is that over a period of time, hiring freezes get absorbed in our operations. Some of that could be a function of changes that we have to make in terms of our cost base of operations. Some of those things can also be from the customer's side, in that hiring freezes seldom are long-standing with customers. Because the customer has to replace some degree of departures, due to attrition. Of course, not all departures. But customers find frequently that attrition continues, and in some respects, they may consider that convenient. But in other respects, they frequently lose people that they need for the future – and to build their business. So over a period of time, hiring resumes.

In addition, we know that at least one of these organizations – which is a very large organization – employing tens of thousands of people – is in the midst of a corporate metamorphosis. As part of that metamorphosis, the Chief Executive has announced that he wants to build a company which is culturally different from the one that he inherited. More nimble, speedier, etcetera. We'll need a different kind of employee to do that. Of course, that will create opportunity for us. So hence, my comment on the continuing relationship is particularly important.

But over a quarter, we are unable to react in our business. We are simply unable to react to short-term fluctuations in demand from our customers. Over a longer period of time, we can and would expect to react to those changes. But in the short-term, that's not possible.

The second thing, which some of you have suggested, is that there could be an impact on certain pending legislation in the Australian market, with respect to labor regulations. This does not have a direct impact on our business, and I will say I'm certainly not an expert in Australian labor law, by any means. And frankly, we just don't have the data to be able to give a coherent answer – whether that pending legislation does or does not have an effect on that business. We don't want that to be interpreted as any kind of excuse.

I will again say if it is having an impact, generally on the customer's tendency to increase permanent employment, my experience has been over a period of time. Again,I can't put a number on it. I can't say it's going to be 1 quarter or 2 quarters or a specific period. But over a period of time, those changes get absorbed into the labor markets. Over a period of time, they do not have long-term impact on demand for our services.

Turning to New Zealand. New Zealand is a smaller component of the ANZ sub region,.ANZ is a large component of what we report as Asia-Pac in our segments. New Zealand is a smaller component, but has been a very profitable business for us. We have a very competent management team there, as we do in Australia.

The situation in New Zealand is that there was an election in September, which resulted – much like our election in 2000 – and the German election this year – in a very close vote – in which there was no apparent winner. My understanding is that there was a considerable amount of uncertainty for a number of weeks, post-election, which caused the business community, perhaps, to reduce demand for new hires and new employees.

Part of the election dealt with a party which had a more radical political agenda than the preceding administration had had. Therefore, it created a certain amount of uncertainty. Uncertainty is always the enemy of permanent recruitment. The simple-minded logic is that employers faced with the possibility or prospect of hiring someone on a permanent basis will hesitate to do so in the light of uncertainty.

In the U.S., we are most-familiar with that in the form of economic uncertainty. Political uncertainty doesn't have a major impact on businesses in our country. But in Australia, New Zealand and in Europe – as a matter of fact – political uncertainty, from my experience, is absolutely a fact and can be a fact in terms of demand for our services.

Again, my experience has been that over a period of time this tends to reach an equilibrium. This is still a society that is suffering a severe skills shortage. A severe shortage of demand over supply. Even more severe than in Australia. While I can't guarantee that this is going to be cleared in

a quarter or two quarters, I will say that my experience is, over a period of time, again, societies adapt to whatever regime ends up in power. And to some extent, business continues more or less per normal.

Turning to North America. Again, to put this in context, North America has been a market which has been very fast-growing for us throughout this year. Again, as we pointed out in our press release, in the first 9 months, revenue was up nearly 40 percent compared to a year ago. In October and November, we were still running at more than 20 percent better than a year ago.

We have seen in the months of October and November, a shortfall in margin in two of our groups. IT and Financial Solutions. I want to discuss each of these. Taking Financial Solutions first, this has been a practice group, as we call it, that's grown very rapidly during 2005. We had a very strong year last year and a very strong 4th quarter last year, as Sarbanes came to its absolute peak.

Through the year, we've seen very moderate sequential growth in that group, which we – frankly – have been quite happy with. What it means is, we've been diversifying our business out of Sarbanes and into other kinds of business. We've been – as I said – quite happy with that. We've also seen, over the course of the last couple of years – an improvement in our bill rate. From $50 an hour to $100 an hour. We've continued to run gross margins in the low 30s. We think this is a very strong market for the company on a long-term basis.

We continue to believe and I continue to believe that the auditor-independence rules will drive business to non-Big 4 entities – including entities in our industry. Our challenge is to continue to get share of wallet of that business.

We obviously have had a bit of a soft 2 months in the quarter. But in no way do we think that this fundamentally indicates anything wrong with our business model or our team in that business. We are quite enthused about it. We remain enthused about 2006 in that business. But we are conscious of the fact, and we've disclosed that we've had a soft patch here at the beginning of the 4th quarter.

The IT business, I would look at somewhat differently. I've been cautious. I think – I hope – those of you who've heard me on prior calls… Remember, I have been cautious about IT for all of 2005. I've remained cautious in terms of our outlook for IT. North American IT, in particular in 2006. I think I've mentioned over time that that cautiousness was one of the reasons for what many of you regarded as a cautious outlook, in terms of revenue growth for next year.

Nevertheless, our IT business is an extremely profitable part of our North American operations. We have a very confident practice-group leadership that I would say is excellent, in terms of bottom-line management. This is something where we have absolutely experienced a degree of gross margin softness at the beginning of the 4th quarter. We don't think it's a long-term trend. We are cautious on the business. Again, I think that my experience is that our business can adapt. Even if this were a trend, it's within the range that our business can adapt to it over a period of time. We have the management team to do it.

I wouldn't view this as fundamental. I don't view the IT business – although it's extremely profitable, and I expect it to be so next year… I don't view it as a great growth engine for 2006. I think, frankly, we just don't have the visibility – enough visibility – on the IT spending cycle. I don't think we're in any different position. Not only compared to any of our competitors, but frankly compared to any of the companies that operate in the broad IT market.

With that, I want to turn -- before I complete my opening remarks -- to just talk about the development of the '05 guidance. A number of you have raised legitimate questions about, "How did we go about developing guidance? How could we possibly have increased our guidance 8 weeks ago and turn around now, 8 weeks later, reducing it back to a level that we were at?"

Well, we're certainly disappointed to be doing that. We have been surprised at the developments in the 4th quarter, as I mentioned, and in the markets that I've just discussed. I want to assure you that the '05 guidance was my responsibility. I approved it, and I would not have approved it if I didn't believe it, and if I didn't have a high degree of confidence that we could've achieved it.

I'm in the unfortunate position of coming here today to tell you that that confidence was wrong. But I want to assure you that that was developed very seriously. It was something that was not taken lightly. And yet it has turned out to be wrong.

With that, I just want to ask Rich Pelhke, our former CFO, who was obviously also involved with the development of guidance, to add his input on that topic.

Richard Pelhke - ***Hudson Highland Group - EVP***

Thanks, Jon, and good afternoon, everyone. I do want to add my insights, along with Jon's, relative to the fact of how we formulated the guidance that we have now changed, today. I do echo what Jon said. We very much give a very thoughtful consideration. I'll share with you some of that consideration as to how we've developed from where we were, and where our confidence came from.

If you will recall, all along this year, we have been expecting our overall revenue growth for the company to be about 12-15 percent. If you take that number, as many of you have, off of our '04 revenue base, and then consider on top of that our operating margin target that we issued, of 1.5 to 2 percent… At the end of the 3rd quarter, that would have given you an implied range of EBITDA of about 21-29 million – and certainly, that's the base of where we're operating from.

At the end of 9 months, we had reported EBITDA of about $22.5 million. In addition, you may recall that later in the 3rd quarter, we acquired Balance – a contract staffing business – financially oriented in the Netherlands. We do expect to receive accretion from that acquisition in the 4th quarter. When you factor in that accretion – combined with a 4th-quarter performance that we expected to be above last year's performance – even with the strong performance that we did experience in North America from some of the Sarbanes Oxley work – we felt very comfortable that a $30-34 million range made sense for the company – given the operating trends we were attaining and the positive operating leverage we had been experiencing all year.

What certainly has developed is what Jon has explained to you. Over the first 2 months of the 4th quarter, while both surprising and disappointing, that certainly reflects how heavily reliant and sometimes susceptible we are to operating leverage.

In this particular case, by having customer-affecting actions – which has happened in relatively short order, overall adjusted our gross margin. When you think about our overall base of business, not too materially, a large number gross margin… The reverse leverage of that in the short-term does affect our profitability, because we're building such a small base as we've been continuing to build the business.

That's what has caused us… Caused the division of guidance from where we were 8 weeks ago to where we are, today. We certainly didn't believe that our continuing operations would be affected to the degree they were, as we kind of risk-adjusted our expectations, going into the 4th quarter. I think that's why we are where we are, today.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thank you, Rich. Before I open it up to questions-and-answers, I want to just address 2 questions that a number of you have asked, today. I think these are very common questions or issues that are on your mind as investors. We should just address those, up front.

The first question has to do with why we're not issuing 2006 guidance today. Let me say, just from my standpoint – being here today and telling you that we've had to reduce our guidance, I'm extremely conscious that when we come out with our guidance for 2006, we certainly want to have a high degree of confidence that we can achieve the guidance that we give you.

I know all of you are frustrated. I know a number of you are unhappy that we've not been able to give you an updated view of our guidance for 2006. But I want to ask Mary Jane – our 22-day employee – to just give you some background, in terms of how we go about the process of developing guidance. Give you some insights into that process. Mary Jane?

Mary Jane Raymond - ***Hudson Highland Group - EVP, CFO***

Thanks, Jon.

As Jon said, our comments that we would update the 2006 guidance was the 2005 earnings release. It's a purposeful statement that we were very thoughtful about.. First of all, in light of the issues that we saw in the latter part of October and November, we did as we did today, mean to tell you what we knew when we knew it. But in light of next year, we are also conscious of being sure that we neither under-react nor over-react.

Some of these issues, as Jon described them, are client-specific. Some may be short-term issues. Issues in markets where we nevertheless think the growth is strong. Therefore, it seemed to us that the correct thing to do was to continue on the path that we were for the confirmation of the 2006 guidance – which was to complete the review of our 2006 operating plans.

Those plans are being prepared by our markets. Are being prepared with the long-term goals in mind. In particular, our commitment to delivering continued and sustainable profitability. Should any of the factors that we've seen in the 4th quarter cause effects next year, or as we evaluate them further, we will work with our management – who is, in each market, both very experienced in this industry and very experienced in their markets – to manage accordinglyso that we achieve our long-term goals.

So we mean to – as Jon said – set our guidance with care. And with the sense that we will achieve it in the continuation of the long-term strategy that we have.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thank you, Mary Jane. The last question I'll deal with, in terms of the number of questions that have been asked to us, is a question…basically… "If these conditions persist, how will you react?"

Again, I'll turn it over to Mary Jane in a moment. I'll just add my thoughts about this. One thing in our industry is that because of the nature of our cost base, which is not… I often say it's fixed. It's not fixed in the sense that we have cement plans dotted around the world that we have to torch. It is fixed, in the sense that we have a base of employees that are working for us. And we have assumptions built in on their productivity, and so forth and so on.

So that in our business, it is very difficult -- in fact, it's impossible -- to react to very short-term fluctuations in demand. If we believed that these were long-term conditions that were going to persist, we would absolutely take actions in terms of revising our expense base.

I'll just turn it over to Mary Jane and perhaps comment on that – just from a financial standpoint.

Mary Jane Raymond - ***Hudson Highland Group - EVP, CFO***

I think that's right, Jon. As Jon said, it can be often difficult in the short-term to make adjustments. But with a longer view of conditions that we may see, we would look with the management team, and in fact, with the employees, at the options that we have to modify how we are spending expenses, what other options we have to ensure that we continue to focus on the goals and take advantage of the fact that should we see something with a longer-term trend to it, we take advantage of that time to act accordingly.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thank you. With that, Operator, we'll open it for general q-and-a.

Operator

At this time, I would like to remind everyone, in order to ask a question, please press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the q-and-a roster.

Your first question comes from Matt Litfin with William Blair.

Matthew Litfin - ***William Blair & Company - Analyst***

Good afternoon. I have a few questions, here. First, of the $5 million EBITDA shortfall in the 4th quarter, can you quantify for us how much of that came from ANZ, and how much came form North America?

David Kirby - ***Hudson Highland Group - Director IR***

Matt – David Kirby, here. Thanks for the question. We're not going to quantify it specifically, but we pointed to the issues that Jon has raised, and we highlighted in the press release, in both Hudson Australia New Zealand and Hudson North America, because those are both significant

contributors to this problem. The quarter's not closed, yet. So the final numbers are not determined. But to the range that you're citing and the range that we've lowered the guidance by, rest assured that both those regions are significant contributors to that number.

Matthew Litfin - ***William Blair & Company - Analyst***

Let me zero in on the North America's F&A, then. So it's not a macro issue. In other words, it's not a size- or growth-of-market issue. It's not your team, which you expressed confidence in, with the Hudson North America Finance & Accounting. You talked about a soft patch. Can you tell us what it is, then, in your opinion? Is it bad forecasting? Just give us some guess – your best guess as to what it might be.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I don't have a best-guess. I would say what happens in this business is, we're in the solutions business. In any particular quarter, we have projects that are coming on and projects that are coming off. In a perfect world, obviously, the idea of more projects coming on than we have coming off. In a single quarter, that doesn't always work that way – particularly when we have a relatively small business.

In projects where we have a gap between the projects that are coming on and those that are coming off, we get hit because we have a number of bench employees, in this model, and we're paying them. That hits our gross margin. If I had to guess, some of it is simply that simple.

At the end of the year, obviously, there are projects that are getting finished. Normally, the end of the year is a pretty strong period. We had a very strong period a year ago. But it's also a time when people are not really rushing out to start new projects. So as we look out to 2006, I just am still confident that this tem is going to deliver. I just don't see anything that's going to stop us from delivering in 2006. I'm not guaranteeing a particular bounce-back in a particular quarter. But as I look out across 2006, I think this team will deliver.

Matthew Litfin - ***William Blair & Company - Analyst***

Just bear with me for a couple more, here. In terms of liquidity, in the short-term, how has collections activity and DSO cash flow been? And then longer-term, how do you feel about that balance sheet at this point?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Mary Jane?

Mary Jane Raymond - ***Hudson Highland Group - EVP, CFO***

With respect to the collections in the 4th quarter, we have seen good collections in the 4th quarter, and are pleased with the advances that we've had particularly with respect to collections. Going forward, staying focused on our cash flow from operations, as well as our overall liquidity, is a major focus area for us.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

We haven't seen anything adverse. In fact, the reverse. It's been modestly in improvement, at the end of the year, for a whole variety of reasons.

Matthew Litfin - ***William Blair & Company - Analyst***

Then last question, if I might. So there's no 2006 guidance being offered, obviously. But do you still expect, in 2006, to improve that profit margin toward your long-term goals? Ttoward that steady progression that's been kind of part of the investment piece this year?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

The way I think about this, Matt, is I do expect 2006 to be an improvement on our profitability – above the 2 percent level that we will report for 2005. I obviously don't want to – and I think my team is resistant – trying to put in parameters around that, right now. But we do expect to have improved profitability.

Matthew Litfin - ***William Blair & Company - Analyst***

Okay. Thank you.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thanks, Matt.

Operator

Your next question is from Mark Marcon with Baird.

Mark Marcon - ***Robert W. Baird - Analyst***

Hi, Jon.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Hi, Mark.

Mark Marcon - ***Robert W. Baird - Analyst***

With regard to the F&A, do you have a sense for how much your practice group is doing, in terms of Sarbanes Oxley? Is that part of the reason why there may be a bit of a decline or soft patch?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I think, again, I don't know, Mark. But that would be a logical assumption. Obviously, our Sarbanes work has been declining through the year. But I will say also that it has held up a lot better than we thought. We've picked up business from foreign filers and the small company filers and the other people that are now dealing with Sarbanes, this year. There's no question that we're seeing a decline in Sarbanes, on the one hand – but an increase in non-Sarbanes on the other.

I think it's reasonable to think that one of the… This is not – as Rich pointed out quite accurately… We're talking about relatively small amounts of money, in the sense of… And not to say it's not serious. But in the sense of the number of contractors. If you want to, think about it that way… that are creating the difference, let's say. It's not a monumental number. Because it's profitable but small business. And it's reasonable to think that there's a little bit of a gap between some of the falloff of Sarbanes and the startup of some other things.

Mark Marcon - ***Robert W. Baird - Analyst***

Do they have skills that are transferable from Sarbanes over to other areas that you think next year they could be fully-engaged?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I'll turn to one of my accounting experts who knows a lot more about the details of what a Sarbanes person does. Mary Jane – what are your thoughts?

Mary Jane Raymond - ***Hudson Highland Group - EVP, CFO***

My thoughts on this are that certainly, the skills are transferable. In many ways, I think for our company where it is – Sarbanes is a good training for finance people, in broadly looking at a number of financial issues. So, yes, certainly.

Mark Marcon - ***Robert W. Baird - Analyst***

So, basically, the issue is that you ended up seeing a drop-off in Sarb-Ox work and you just didn't have enough non-Sarb-Ox work to replace it?

Jon Chait - ***Hudson Highlands Group - Chairman and CEO***

I don't specifically know that, Mark. We don't have our business calibrated that finely. But I think that's one possible explanation.

Mark Marcon - ***Robert W. Baird - Analyst***

Just to be clear – are you actually seeing a sequential decline in this quarter relative to last quarter in F&A? Or is it just a slower year-over-year change or potentially a decline?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I don't know that…

David Kirby - ***Hudson Highland Group - Director IR***

I'm not sure if it's sequentially, but we'll look at that. We have seen declines, though, throughout the year. So it has been growing. And the quarter's not closed yet. We'll see where that comes up.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

One of the things, Mark – just to appreciate – and this is particularly true in North America, but it's clear in Australia and New Zealand, as well. We don't have December in. And December is a material part of the quarter. In Australia and New Zealand, in fact, December's the biggest part of the quarter.

Obviously, we wouldn't make this announcement unless we thought we had to. It's hard to draw big conclusions when we still have a month to go. We have some visibility on what happened, but we don't have perfect visibility on what's happened in that month.

Mark Marcon - ***Robert W. Baird - Analyst***

I was just trying to get a sense of if you're looking at your weekly stat reports – whether you're actually seeing a decline, or whether it's holding steady or just not improving as much as you had anticipated.

David Kirby - ***Hudson Highland Group - Director IR***

Well the thing we're referring to, Mark, in the release, is the 40 percent growth rate that we've seen for the 9 months of '05, year-over-year, in North America.

Mark Marcon - ***Robert W. Baird - Analyst***

Yes.

David Kirby - ***Hudson Highland Group - Director IR***

And frankly, it's been pretty good – but less than expected. And much less than that 9-month growth rate of a 20 percent growth rate for the 2 months – October and November -- of this quarter versus last year. So that's hopefully something tangible that everyone can look at and contemplate.

But our North American business in total – which those numbers speak to – has obviously been growing well, and is small – relative to a lot of its peers, even in a number of practice areas. Normally, that's a good opportunity for us to be nimble and to grow faster than some of those peers. In this case, it's caught us a little bit by surprise. Those small groups have been affected by some actions – maybe more on a macro basis than a larger business would be.

Mark Marcon - ***Robert W. Baird - Analyst***

Then with regards to the IT practice in North America. Are you being impacted specifically in a couple of very specific practices? Or is this widespread?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I would say a little bit of both. One of the things I think we've talked about over the year is that we have a small-but-profitable IT solutions group that was really built around one client. We've tried to diversify this business, but it's kind of the law of nature. You have an excellent client, and then it's sometimes hard to get everybody focused on doing something else.

The client, in late 2004, got acquired by another entity. The other entity has a different philosophy about the services that we were performingwhich is one of those things that happens. So through the course of the year, we've been losing business – drip-drip-drip – from that particular situation. In the previous 9 months, the team has compensated for it by getting other businesses. So, keeping the numbers basically flat. That's caught up with us a little bit in this quarter.

Again, in 2 months in the quarter, we're not sure we're even willing to say that for the whole quarter. But certainly in the 2 months, it's caught up with us a little. But as I said to you in my opening remarks, I don't perceive that this is a long-term hit to profitability. This is a very profitable business. The management team here is very bottom-line focused. I have every confidence that if this were a persistent problem, they would adapt to it. Just that they can't adapt to it over a very short period of time.

Mark Marcon - ***Robert W. Baird - Analyst***

In terms of the outside of that one business solutions practice.] I mean, how much of a decline are you seeing in just your traditional staff augmentation business?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Again, it's not that much in terms of numbers. If you look at the number of contractors, and if you look at it in terms of margin – none of these are big numbers. It's just that we have a small base. I would say that we're also in accordance with the legal rules. One of the issues is, once we make an announcement, we have to announce everything. If these were the only things we were looking at, we wouldn't be making an announcement. These are not big enough, in and of themselves. Nor do we believe that they're material, in any way. So we wouldn't have brought this up. But having been in a position where we had to make an announcement, then we felt it was incumbent upon us to come forward with all the facts.

Mark Marcon - ***Robert W. Baird - Analyst***

Great. Thank you.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thanks, Mark.

Operator

Your next question comes from Jeff Silber, with Harris Nesbitt.

Jeff Silber - ***Harris Nesbitt Gerard - Analyst***

Thanks. Just to put things into perspective –I just wanted to see if we could quantify some of the exposure that you have. Can you tell us roughly what your exposure is in New Zealand? Either as a percentage of revenue or as a percentage of growth profit? And the same thing, in terms of your IT practice and F&A practice in North America.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

David, I'm looking at you.

David Kirby - ***Hudson Highland Group - Director IR***

Jeff, that's a good question. What we do release on a quarterly basis in our segment data is data for Hudson, Highland, Americas, Europe and Asia-Pac. So I'm looking at the Hudson Asia-Pac business, which is where Hudson New Zealand falls. Hudson Australia-New Zealand makes up 80 percent or roughly 80 percent of our Hudson-Asia-Pac business. Depending on what line of the P&L you're at, Australia is about 3 times the size of New Zealand.

So that should give you some data on the relative size, there. We're obviously seeing a slightly bigger slowdown in New Zealand then Australia, to raise it to the level of our disclosures, today.

In terms of the practice groups in North America – the second part of your question, Jeff. Our 3 main practice groups that we're focused on growing over the long-term in North America and globally, for that matter, are IT, accounting-finance, as well as legal.

We've noted, obviously, IT and accounting-finance as having some softness here, today. Those 3 practice groups together in North America make up a little bit more than 70 percent of the North American business. We would rank them with recent data as legal being our largest business, IT being of a similar size, and accounting-finance being a bit smaller.

Jeff Silber - ***Harris Nesbitt Gerard - Analyst***

Okay. That's actually helpful. Thanks.

One of your largest geographic areas is the U.K. You haven't talked about that at all, yet we've seen some – I guess slower – macro indictors, out of that area. Can you talk about what's going on in your business in the UK for us?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Sure. We've had a fantastic year in the U.K. What's driven, and to some extent it's been a little bit helped by macro-economic indicators. But it's been much more company-specific.

Our team there has been very focused on improving the profitability of our overall operation there – and frankly, I think on any measure, has done an excellent job.

We believe and continue to believe – notwithstanding the macro-economy - it certainly was slower in the second half of the year, and I think the forecasts for at least the first half of next year – are not very robust. But we still expect to improve profitability in the U.K. in 2006. That's much more driven by both the annualization of changes that were made in the second half of this year, as well as continuing productivity improvements that our team believes they can achieve in 2006.

We haven't talked about it, because I think in this kind of situation – again – I don't want to be accused of trying to minimize the bad news. But we feel that both in the U.K. and in Continental Europe, we're positioned to have – I think – a very good 2006.

Jeff Silber - ***Harris Nesbitt Gerard - Analyst***

Okay. Great. One more question on a different topic. I know Rich is going to be staying on as a consultant over the next year. Can you give us a little bit more color, Rich, what your role is going to be? How much time you think you'll be spending with the ompany, etcetera?

Richard Pelke - ***Hudson Highland Group - EVP***

Well, I'll be working with Jon on a number of strategic things that we've been working on all along. I'm available to Mary Jane to help her with the transition. We haven't poured a hard definition of hours, or anything – but we've been working pretty closely over the last month or so already. That'll continue on, into the New Year.

Jeff Silber - ***Harris Nesbitt Gerard - Analyst***

Okay. Great. Thanks a lot.

Operator

Your next question comes from Mike Carney with Aperion Group.

Michael Carney - ***Aperion Group - Analyst***

Good afternoon, everyone.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Hello, Mike.

Michael Carney - ***Aperion Group - Analyst***

A couple of questions. First, in Australia New Zealand. You've talked about the Perm, but didn't mention the temp. Has the temp had the same type of declines? Maybe of those specific customers? I imagine you also do temp?

Jon Chait - ***Hudson Highlands Group - Chairman and CEO***

We do do temp with those specific customers. We have had declines in our temporary business. If you look at it from a standpoint of temporary gross margin, we've also had declines against our expectations – but not of the same magnitude. So we haven't viewed that in the same light, so to speak. We continue to supply large numbers of temporaries to all of those customers that have implemented hiring freezes in permanent recruitment.

Again, that was the premise of my comment. From everything I've seen, I don't believe it's a relationship issue.

Michael Carney - ***Aperion Group - Analyst***

Also, are these the professional skilled? Or is this more industrial or commercial skilled?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

It's a very good question, Mike. I know you've been following the company quite some time. So you're probably awarebut just for the rest of the audience. In Australia, it's one of the places in the world where we actually have a much broader business beyond professional. We have a particularly strong business in service support. Our industrial business is much smaller.

From the data I've seen, this hiring freeze doesn't particularly affect industrial. Because these companies are not big users of industrial services. But it does affect/it is not limited to professional. It is kind of an across-the-board. Because I think in all of the companies, we supply service and support people and other non-professionals. What we call, "non-executive," categories.

Michael Carney - ***Aperion Group - Analyst***

Also, you've made a lot of productivity improvements in those countries in the last couple years. A lot of the market there has gone to procurement-based hiring. So, had you made all of the productivity improvements in terms of basically not needing as many recruiters, not needing as many salespeople out there, up to this point? Or assuming that the economy is still fairly robust there, do you think there's more productivity improvements that you can make significantly? Or not?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I think our way of thinking about it – when we built the '05 guidance – was that we expect there are some smaller continuing productivity improvements that we could make in Australia and New Zealand. They are certainly not of the magnitude that we have made over the last few years. I think you remember what the levels of possibility were a couple of years ago.

I think we felt there were some continuing opportunities. But much smaller, in our mind. We had seen the Australia-New Zealand business as a very mature business, not growing very fast. But contrary to what you might think with this announcement, a business that was very stable and very profitable. And was really one of the foundations, so to speak, of the company.

We were disappointed, obviously, at what's come about, here. But as I say, we don't think it's fundamental. We had really looked to our other operations. Particularly, North America and Europe, for growth – in terms of profitability and revenue.

Michael Carney - ***Aperion Group - Analyst***

Then turning to the U.S. The 4th quarter of last year was the first really, really strong quarter. Did you expect growth to be above 20 percent? Revenue and growth to be above 20 percent in the U.S. in the 4th quarter of this year?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I think our expectations were not that finely calibrated. I think you may recall, Mike, when Rich and I had come out with our 12-15 percent revenue guidance for the year, some analysts felt that that was very, very cautious. We had, at the time, mentioned to people that we felt that the 4th quarter comparison would not just be a tough comparison, but it's just the law of maturing numbers or big numbers – or however you want to put it.

So we still feel that this is a business that our North American business is a business that's going to grow. We think it'll grow kind of above the market. So I don't think we had it finely-enough calibrated to say whether it was going to be 20 or 25. But we certainly didn't think we were going to… You remember earlier in the year when we were growing at very high growth rates. We certainly didn't think that was going to continue in the 4th quarter.

Michael Carney - ***Aperion Group - Analyst***

Okay. So basically, it seems like if that's really contributing somewhat to the revision – I assume not as much as Asia-Pacific is- Not that you didn't speak to that. But I would imagine that it's really the gross margin in the U.S. – if you're having pricing pressure – that's lower. Is that correct?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

That's right.

Michael Carney - ***Aperion Group - Analyst***

Okay.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

That's right. And that's really what it is.

Michael Carney - ***Aperion Group - Analyst***

Then finally, in the U.K., the business… Isn't most of the business toward financial services and related firms?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

No. The U.K. Certainly, financial services firms are big customers. Absolutely, in all categories of things that we sell. But we're pretty diversified.

Michael Carney - ***Aperion Group - Analyst***

Okay. Thanks a lot.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thanks, Mike.

Operator

Your next question comes from Ty Govatos with CL King.

Ty Govatos - ***CL King & Associates - Analyst***

Yes. Can you refresh us on the percentage of the Australia – New Zealand business that is permanent-placement? And what those percentages are in the U.S. for North America?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I can certainly do it in round numbers. Then David can tell me if I've got it too rough.

David Kirby - ***Hudson Highland Group - Director IR***

We'll just do it directly then.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Okay.

David Kirby - ***Hudson Highland Group - Director IR***

Ty, in North America, Hudson, we're basically 80 percent temp and 20 percent perm at the gross margin level. In both of our international markets, frankly – Hudson Europe and Hudson Asia-Pac, we are essentially 2/3 perm and 1/3 temp, with an additional share of Human Capital Solutions. obviously I took it 2/3 – 1/3 but there's a little bit of HCS in both of those.

Ty Govatos - ***CL King & Associates - Analyst***

Yes.

David Kirby - ***Hudson Highland Group - Director IR***

So we are perm-dependent, internationally. When you blend that together, we are about 55 percent perm, on a global basis – about 35 percent temp on a global basis – and about 10 percent coming from HCS. Is that helpful?

Ty Govatos - ***CL King & Associates - Analyst***

Yes, it is. So I can assume that from what you're saying, by far the largest part of the problem in Asia-Pac Australia/New Zealand was the perm side of the business?

David Kirby - ***Hudson Highland Group - Director IR***

Yes. We've echoed that throughout the call.

Ty Govatos - ***CL King & Associates - Analyst***

Can you say the same in the US?

David Kirby - ***Hudson Highland Group - Director IR***

No. One of the things we're pointing to in the release is pricing pressure and margin pressure in the U.S. and focusing on the IT business and the accounting-finance business. Given that 80 percent gross margin comes from temp, and 20 percent comes from perm, and we were describing this as softer-than-expected demand.

We're seeing some softness in both those areas. But given that 80/20 split, and the language that we use to talk about contract pricing pressure, that means pricing pressure in the temporary business – in the contract business. That's where we're seeing some of the weakness, today.

Ty Govatos - ***CL King & Associates - Analyst***

Fair enough. Thanks an awful lot.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Thank you, Ty.

Operator

Your final question comes from Mark Marcon with Baird.

Mark Marcon - ***Robert W. Baird - Analyst***

I want to follow up on that point, and then a couple of other questions. With regards to the pricing softness – on the IT side, is it across-the-board? Or is it primarily just on that solutions business that you're transitioning?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

We don't have the data calibrated that way that we can give you a definitive answer.

Mark Marcon - ***Robert W. Baird - Analyst***

I guess the reason why I'm asking the question, Jon, is I'm trying to understand if it's truly an environmental issue that's going to impact everybody across-the-board, equally, and that you're just the first one to disclose it. Or is it more of a situation of – in the case of your IT practice, you do have this highly profitable solutions business that's been impacted by the dynamics that you indicated? And then on the F&A side, are we looking at a situation where there may've been a little bit of a mismatch on a temporary basis, in terms of some of the Sarb-Ox work rolling off and not immediately having some assignments to replace it?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Let me take the easier one, first. I think on the F&A side, I see it as more of a temporary as you say mismatch or margin pressure, or whatever – however – we want to define it. I don't see it, as I said before in my opening remarks… I don't see it as something that will impact 2006, as a whole.

Without guaranteeing you that the first quarter… I can tell you what will happen in the first quarter.

Mark Marcon - ***Robert W. Baird - Analyst***

Sure.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

In the IT business, I don't think that we're a very good indicator of the market. We have a quirky little business that's pretty different from most of our competitors. We are not playing in any of the big contracts. That eliminates a few of the very large competitors that play in procurement-driven large accounts. We don't do that.

We also don't play in payrolling, which also eliminates a few of our competitors. We pretty much focus on not necessarily small clients, but we focus on highly-specialized small numbers of teams, highly-specialized people, and a pretty good gross margin.

I'm saying that my belief is that it is not a long-term problem – even for our business. I mean, long-term being '06, as a whole. However, I also said that if it were long-term, we could adjust to it.

Mark Marcon - ***Robert W. Baird - Analyst***

Then we haven't talked about your long-term aspirations. In the past, you've talked about 7-10 percent long-term margin aspirations. I'm assuming that you're not backing off of that from a longer-term perspective. And I was wondering what sort of revenue growth would you need, over the next few years, in order to achieve some material improvements in the EBITDA margins?

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

Well, Number 1 – I'm not backing off, at all. I think 7-10 percent is absolutely our goal, and I think it's achievable. It's, in the short-term, a little tougher. But I think we have enough room to make our company more productive to reach those numbers.

What I said is that I feel there's some requirement for additional revenue growth. But I don't think that's fundamental to our being a more-profitable company. In my mind, I always think, "If we had 10 percent revenue growth, that would make life a lot easier." But my challenge to the organization is, "This is a business that's going to be close enough to 1.5 billion. We ought to be able to achieve the profitability levels with that base of business." That's not an unreasonable way to look at our business. And I've found that my colleagues agree with that.

So we've spent our focus on building this as a profitable, sustainable business. If we have the revenue growth, that's great. It makes our job easier, but it's not fundamental.

Mark Marcon - ***Robert W. Baird - Analyst***

Terrific. Thank you.

Jon Chait - ***Hudson Highland Group - Chairman and CEO***

I think, Operator, that's our time limit. Let me just close. David's going to wrap up. Let me just close by thanking you all for attending. I'm sorry it's under these circumstances. I will wish you a Merry Christmas. And David, will you just make the closing remarks?

David Kirby-- ***Hudson Highland Group - Director IR***

Thank you for attending our call, today. The call has been recorded and will be available later today by calling 800.642.1687, followed by the pass code 3846438. If your call is outside the US, please dial 1.706.645.9291, followed by the same pass code.

This call will remain available for the next 7 days, at those numbers. Today's webcast will also be available on the IR section of our website, HHGroup.com.

Thank you all very much.

Operator

That concludes today's Hudson Highland Group Conference Call. You may now disconnect.