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Conference Call Transcript

HHGP - Q1 2007 Hudson Highland Group Inc Earnings Conference Call

Event Date/Time: May. 03. 2007 / 9:00AM ET

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PRESENTATION

Operator

Good morning. My name is Amy, and I will be your conference facilitator today. At this time, I would like to welcome everyone to the Hudson Highland Group's first quarter 2007 earnings conference call. [OPERATOR INSTRUCTIONS.]

I would now like to turn the call over to Mr. David Kirby, Director of Investor Relations. Sir, you may begin your conference.

David Kirby ***- Hudson Highland Group, Inc. - Director of Investor Relations***

Thank you, Operator, and good morning, everyone. Welcome to the Hudson Highland Group conference call for the first quarter of 2007. Our call this morning will led by Jon Chait, Chairman and Chief Executive Officer, and Mary Jane Raymond, Executive Vice President and Chief Financial Officer.

Before we begin, I will read the Safe Harbor Statement. Please be advised that except for historical information the statements made during the presentation 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 now turn the call over to Jon Chait.

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Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Thank you, very much, David. And good morning, everybody. Thank you for joining us today.

The first quarter represented a solid quarter, while we managed through several operational management changes. I'm going to spend a minute today to comment on those changes and give you an assessment of where we are at the moment. After my remarks, Mary Jane Raymond, our Executive Vice President and Chief Financial Officer, will go through the financial results in more detail.

At the risk of stating the obvious, Management's stability and retention is an important driver of success in our industry. Nevertheless, it has been four years since our spinoff from our former parent. During that period we have made significant progress as we have moved from a Company that lost $60 million on an operating basis to one that has been consistently profitable for the last couple of years.

More importantly, we have moved from a Company that was composed of a vast array of small acquisitions to a more integrated global business. That move brings a more disciplined way of doing business, which in today's regulatory climate is simply non-negotiable.

Today, we are focused relentlessly on improving the profitability of our Company. We think we have a great opportunity to make Hudson an industry leader, but we recognize that we have work to do to increase the level of our profitability. The combination of these factors results in a fairly high degree of Management stress. We continually reassess everything that we've been doing even if it seems successful.

Some of our operational leaders ultimately may not be prepared for this significant effort and change management work required to reach our goals, so changes in leadership should not be surprising and, in fact, should be expected over time.

Turning to the regions, as you know, I've been serving as Interim President of North America since Tom Moran's departure at the end of March. While operating that business, I'm evaluating the practice leadership team members for a possible internal successor, which is still my preference. I expect to make a decision within the next quarter or two, but if necessary will tap talent outside the organization to fill the role. I'm pleased with the level of talent that we have in the North American organization, both at the leadership and operational level. We have pockets of excellence, which will serve as the foundation for the future.

While we experienced a tumultuous leadership change in Australia and New Zealand during the quarter, we have in place today a team with great organizational continuity. Don Bielinski continues as the head of Asia-Pacific Region, Helen Nugent as the Executive Chairman and CEO of Australia and New Zealand, and the update for you is that Gary Lazzarotto, an Australian who has been with the Company for 14 years and most recently served as the CEO of our highly successful Asian sub-region, has taken on the responsibility as Managing Director for the Australian/New Zealand business.

Stefanie Cross Wilson, an American who has worked in Asia for over ten years, has moved from Chief Operating Officer to CEO of the Asian sub-region, following Gary's move. She will lead and operate that business until a successor is in place, and then will move on to a planned new role as head of permanent recruitment in North America later this year.

In the U.K., Andy Rogerson, former head of the Scottish business and a strong operational leader, has been promoted to run the U.K. operation after former CEO John Rose left to run a small local niche market recruitment agency. In that role, Andy will work very closely with Christine Raynaud, who remains in place as the head of Hudson Europe.

I expect there will be further Management changes from time to time, as we continue to drive towards our performance goals. Our solid Q1 results speak to the depth of our operational Management Team, and their ability to step in and continue our momentum.

With that, I'm going to turn over to Mary Jane for a more detailed analysis of the financial results in the quarter. Mary Jane.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Thanks, Jon. Good morning.

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Jon has just finished talking to us about the overall business and our Management Team. Those comments are insightful in light of the ones I'll give you on our results, which is mainly that there are no unusual items in our EBITDA this quarter. Despite the Management changes, our people worked very well together to focus on the base business and deliver a solid quarter.

As a second comment before I do the numbers with you, I'll just point out to you that some of our prior year comparisons for this quarter show some large increases, particularly in Hudson Americas and at the overall EBITDA line. As you may remember, our first quarter last year was weak, and we also restated it. That, obviously, gives us a relatively easy comp against last year. Nevertheless, the first quarter of this year, 2007, was a solid quarter in its own right, being the largest and the highest Q1 we have had at the EBITDA line since our spin.

For this quarter we were ahead of the EBITDA forecast of the analysts by roughly around $4 million, but frankly I wouldn't read too much into that. This doesn't change our view, Jon's and my view, about the rest of the year for our Company. We're certainly happy to have those $4 million rather than not.

Let's turn and talk about the numbers a little bit. Our reported revenue for the first quarter was $337.9 million, with an increase of 3% over prior year. Our prior year revenue included about $5.7 million from two businesses that we recently sold in the U.K., the Scottish Industrial business and the Office Support business.

They, the revenue on a constant currency basis declined about 2%. On a reported basis by region, Hudson Americas increased 2%, Europe increased 5, and Asia-Pac increased 3. Turning to constant currency Hudson Europe and Asia-Pac revenues declined 5 and 3%, respectively.

From a mix perspective on a constant currency basis, temporary contracting revenue declined 5%, about half of that due to the businesses we sold in the U.K. And permanent placement revenue increased about 11%, with Talent Management revenues declining by 4.

We continue to focus on gross margin as the measure of success in changing the mix of our business toward higher margin services. Reported gross margin of $125.9 million increased 14% from prior year, driven by 18% growth in Hudson Americas, 16 in Hudson Europe, and 8% in Asia-Pacific. The gross margin from 2006 included $1.3 million from the businesses we sold and discussed a little bit earlier.

From a mix perspective, our mix is essentially unchanged at the gross margin level from prior quarters, with permanent recruitment remaining the largest contributor to gross margin at about 52% for this quarter versus roughly 49% a year ago.

On a constant currency basis, gross margin dollars increased 7%, including gains of 5% in Hudson Europe and 2% in Hudson Asia-Pacific. Gross margins as a percentage of revenue was 37.3% in the first quarter of '07, compared to 33.8% a year ago. Temporary gross margin as a percentage of revenue increased to 18.3% from 17.1% last year due to better temporary margins in both the Americas and Europe.

Adjusted EBITDA in the first quarter of this year was $6.8 million or 2% of revenue, compared with a loss of $3.6 a year ago. EBITDA, which is adjusted EBITDA less the restructuring charge, was $3.7 million or 1.1% of revenue. The adjusted EBITDA margin was driven by regional margins of 5.9 in Europe, 5.8% in Asia-Pacific, and just about flat or 0.1% in Hudson Americas, along with some reduced costs in corporate. The underlying drivers of the improved gross margin are those we just discussed above, but as well as good operating leverage as the regions continued to leverage more of their gross margin into the EBITDA line.

The restructuring charge in the first quarter was $3.1 million. This completes our 2006 restructuring program and was within our guided range. The costs in the quarter were, as you may recall from our discussion at yearend, primarily for downsizing real estate in London and existing spaces in the U.S. We think that the completion of this program positions us for increased financial strength, as well as improved operating leverage, as we move forward.

Depreciation and amortization in Q1 '07 was $3.8 million, its lowest level so far since our spin. This is helped by lower capital spending in the last several quarters, as compared to the depreciation runoff. That said, capital spending is part of this business, especially as we continue to add to the operating capability of our systems. But I do think that from a depreciation point of view we are moving closer to our ongoing run rate.

As we look at a few other lines on the income statement, we earned about $200,000 of interest income in the quarter, and we also had non-operating income of $2.6 million, mostly from the gain on the sale of the Office Support business in the U.K., done in early January.

So these two -- the number of the U.K. Office Support gain is roughly the same, about 500 less than our restructuring charge of 3.1, so roughly in the same ballpark.

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Our provision for income taxes in the quarter was $2.4 million, due mainly to higher effective tax rate in the U.K., and then higher taxes on the income of Europe and Asia-Pacific. I'll talk a little bit more about our taxes in a minute.

The consolidated net income in the first quarter was $400,000, up from a loss of $8.1 million last year. Regarding the EPS, both from a basic and diluted point of view, it was $0.01 compared to a loss of $0.33 last year in the same period. We had 25.7 million outstanding diluted shares this quarter compared to 24.2 million a year ago.

Just to give you a quick perspective with respect to the sale of the U.K. Office Support business, we did that in early January and mentioned that to you on the yearend call. Our discussion last call, which is that we have essentially about 10% of our revenue in non-core businesses, that's still the same. We expect to be selling those over the next several quarters. That said, those are good businesses, and we expect to continue running them until the process we have in mind is complete.

I'll turn now and give you a few comments on the regions' numbers. Let's start first with Europe. The revenue declined about 5% on a constant currency basis, as they continue to exit low margin businesses. Given that strategy, gross margin dollars grew 5% in constant currency, and their adjusted EBITDA was up 19% from a year ago.

Europe incurred a $2.4 million charge in the quarter, primarily to reduce the occupancy cost of our London office, one of our real estate actions to complete the 2006 program, and this office is one of our more expensive properties. We saw strong EBITDA contributions in virtually every country in Europe, as they continue to move toward a solid track record of results.

In Asia-Pacific, the first quarter revenue declined 3% on a constant currency basis. The constant currency gross margin, though, advanced 2% and EBITDA was up over 14%. Continued strength in the Australian permanent placement market, as well as tight expense control, contributed to their gross margin as well as EBITDA growth in the quarter.

For Asia, permanent placement remained steady against prior year, however, the growth is a little bit slower in the Asia region. And as a result, the EBITDA results were a bit weaker in Japan, Hong Kong, and China. This lower EBITDA result for Asia doesn't overly concern us. Asia is a very fast-growing market, and relatively speaking still on the small side for us. It's about 20% of Asia-Pac's gross margin. So changes in one quarter against another are not unusual. In a region that's growing pretty quickly just about for Asia's whole history, they've had a tough comp against prior year anyway. That said, this is a very important region to us, and we continue to provide that region with support to regain its drive, which we have confidence they'll do.

In Hudson Americas, the first quarter revenue increased 2%, while the gross margin increased 18% on a constant currency basis, largely due, frankly, to a particularly weak Q1 last year. As a result of the gross margin growth and certain cost reduction initiatives, the adjusted EBITDA was nearly breakeven for this quarter which was a significant improvement over prior year. But, frankly, it's still below our expectations. The region recorded a restructuring charge of $700,000 to record an EBITDA loss of $900,000 in the quarter.

As for corporate expenses, we continue to look for ways to reduce these costs, and as such we have a 22% decline in corporate against Q1 '07. One of the things that we did successfully do, for example, is move out of our New York location. The corporate expense for the quarter totaled $6.2 million versus $7.9 in the first quarter. Again, for a variety of things, including more efficient use of staff and lower professional fees.

Just to give you a quick summary on the constant currency impact, our EBITDA result as reported is improved by about $900,000 compared to Q1, compared to the -- the reported result is $900,000 and compares the constant currency. To give you a little bit of year-on-year change in the currencies, the pound is up 12%, the Euro is up 9, the Australian dollar is up 6% and the New Zealand dollar is up 4%.

With respect to our expenses in total, for the total Company, we continue to look at both expense containment and, as Jon has said to you since the beginning of our Company, increased operating leverage over the resources we have in place. The total expenses in adjusted EBITDA were down from prior year at $1.7 million on a constant currency basis. EBITDA leverage was 85% in the quarter on a constant currency basis.

So, as usual, in the last few quarters we've had a few other interesting topics to tell you about, and I'll update you on those. So let's start with PeopleSoft. As we noted in the shareholders letter, the PeopleSoft project remains on schedule and on budget. During the first quarter we experienced some of the improvements that we had anticipated, such as more timely management reporting and efficiencies in the back office. We believe that greater stability in the PeopleSoft application and greater ability of the people to process transactions in that application has allowed us to maintain more steady performance in the North America region.

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With respect to cash flow, in the first quarter the Company used cash in operating activities of $3 million, compared to net cash, the cash generated to $100,000 during 2006, and cash load used of $24.6 in 2005. The cash usage increase in this quarter from a year ago is primarily due to higher DSOs in the U.K. operation, which as you may recall, we moved from London to Scotland. While certainly I would have liked to have the cash flow positive in the quarter, in general, I am very happy with the good focus that we are maintaining on this and, frankly, given the typical Q1 uses of cash flow, this really isn't a bad result.

We had $5 million outstanding on our credit facility at the end of the first quarter, cash on our balance sheet of $47 million. Our DSO was down one day compared to a year ago at 58 days.

Capital spending in the quarter was $2.7 million, up from $1.7 in the first quarter of '06, primarily for systems investments in the U.S., namely PeopleSoft, as well as Europe, and office expansion in Asia-Pacific. This is in line with our expectation. It's consistent with our CapEx estimate of $14 million for the year.

Let's turn and talk about liquidity at a more macro level. We noted in our 10-K and in yesterday's shareholders letter that over the next six months we expect to spend between $30 and $40 million in earnout payments related to prior acquisitions. These earnout payments are commensurate with the performance of these businesses, and the largest payments are scheduled for the third quarter of '07.

We have the option to make the payments in cash or stock. While we have that option, we certainly intend to be very judicious about the use of stock for these payments. We've improved our cash flow trends over the last 12 months which was a purposeful activity and that gives us further flexibility in the forms of liquidity that we have.

With respect to taxes, we incurred taxes of $2.4 million in the first quarter, compared to $1.4 last year. As I mentioned earlier, due to continued profitable results in Asia-Pacific, as well as the gain on the U.K. Office Support proceeds.

Going forward, our tax guidelines are pretty much intact. We expect a rate near 30% for Asia-Pacific, and we expect to pay taxes on profits in the Netherlands from Balance. We also expect to incur tax expense in the P&L. In the U.K., after we finish the recognition of the deferred tax assets in the fourth quarter. Though the cash benefit of these deductions will be realized ratably through, from '06 through '09. We exhausted the U.K. taxable carry forward in '06 and, therefore, the rate will be roughly about 30% on the U.K. profits in the future.

I will comment in the topic of tax briefly on our adoption of FIN 48, which is an accounting pronouncement that is a refinement, shall we say, to FAS 109 and was effective as of the 1st of January this year.

For our Company, this resulted in the cumulative adjustment being recorded to beginning retained earnings deficit of $3.6 million. That consists of $2.1 in income taxes related to non-U.S., state and local jurisdictions, 0.1 of interest on the taxes, and then $900,000 of penalties related to these uncertain tax postitions. For those of you who don't worry about FIN 48 every day, basically this was refined guidance for how companies account for uncertain tax positions which might arguably be described as all of them.

Let me turn now to guidance. As we've done for the pat three quarters, we continue to provide quarterly guidance. We expect the second quarter of '07 for revenue to be $355 to $370 million at the prevailing exchange rate, and we expect EBITDA of $12.5 to $13.5 million. This compares with revenue of $352 million in the second quarter of '06, and EBITDA of $8.5 million in the second quarter of '06. We expect no restructuring charges in the second quarter of '07.

With those remarks, I will turn the call back to Jon for his concluding comments.

Jon Chait *- Hudson Highland Group, Inc. - Chairman and CEO*

Thank you very much, Mary Jane. We're at the point, operator, where we should open up for a question and answer.

QUESTION AND ANSWER

Operator

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[OPERATOR INSTRUCTIONS.]

And your first question comes from the line of Matt Litfin.

Matt Litfin - ***William Blair and Co. - Analyst***

Yes, hi, good morning.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Hi, Matt.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Hi, Matt.

Matt Litfin - ***William Blair and Co. - Analyst***

My question regards the North American finance and accounting division. I wondered if you could just give us a little more comment about what you saw there in the quarter and, you know, how -- what is the, the distinct plan to get that moving in the right direction?

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

I know in our shareholder letter we indicated what the revenue performance was in the quarter, which I'll have to look at to remind myself that we did have a decline in revenue of 7% and a decline in gross margin of 5% in a market that was generally reasonably, I wouldn't say the market was strong in finance and accounting, as you look at other people's reporting, but it was a reasonable market.

I think we certainly have pockets of excellence in our finance and accounting business, and our plan broadly speaking over the next few, certainly over the next few quarters if not few years, is to build upon our pockets of excellence. So I think, you know, we certainly have work to do, but I think we do have a foundation within that business. Admittedly, it's obscured by the overall result, but we have a foundation in the business that has been very profitable and very successful and our plan is to build upon that.

Matt Litfin - ***William Blair and Co. - Analyst***

Okay. And then another question I have on Europe, and obviously we've seen a solid steady trend over the last few years of better profitability from Europe, so the question is is there a lot of variance still here by country? Is it fairly consistent at that, you know, high, mid to high single-digit margin that you are reporting for the overall segment or are there still some unprofitable countries that, and some at double digits?

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Well, I would say, first of all, if you think about Europe again very broadly, you can divide it into two parts, Continental Europe and the U.K. Continental Europe, which is largely involved in permanent recruitment, talent management, and then a very high margin contracting business in the Netherlands in our Balance subsidiary.

Continental Europe is more profitable than the U.K. I know Europe has been double digit in terms of EBITDA percentage, and been moving up over the last couple of years. So, and I think the view from Christine Raynaud, who is running Europe, is that there's additional room to improve with, even within Continental Europe.

The U.K. has been less profitable on an EBITDA, measured by EBITDA percentage, and is the market where we continue to think there is the most opportunity. We recognize that the U.K. market overall is a less profitable market, again measured by EBITDA percentage. But our

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business in the U.K. has been significantly improving its EBITDA percentage, again, over the last couple of years. John Rose, I think did a very good job in that area, and I think Andy is going to build on that momentum.

I think we have the right Management Team in place in the U.K. to continue to build on that and continue to shift our business away from the lower margin segments into the higher margin segments, continue to build our revenue in the higher margin segments. That's why you see the phenomenon in Europe that our revenues are, are slightly down and our gross margins up pretty significantly. So I think that, that's the area where we have, continue to have a good opportunity.

Matt Litfin - ***William Blair and Co. - Analyst***

Okay. Thanks, Jon. A last question for Mary Jane, given what you know what today as you look at these earnout payments over the next two quarters, are you leaning more towards using cash or using stock for those?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, I would say we are keeping our options open. I mean obviously I'm happier or than say we might have been a year ago on our ability to essentially use cash flow, so let's start there. And I'd say that we're pretty mindful of the fact that we want to be sure we have as little dilution as possible, so frankly speaking I'm still looking at what that modeling looks like in the timing of these, but I would say I feel very good about the fact that we have all the options available to us in our hands.

Matt Litfin - ***William Blair and Co. - Analyst***

Okay, great. And congratulations on a good start to the year.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Thanks.

Operator

And your next question comes from the line of Jeff Silber.

Jeff Silber - ***BMO Capital Markets - Analyst***

Thanks so much. Actually, I have a couple of follow-ups from Matt's question. On the earnout payments, I know you say the largest is coming in the third quarter, can you give us some order of magnitude? How large relative to the $30 or $40 million in total?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

I'd say we have probably in the neighborhood of $25 to $30 million in the third quarter.

Jeff Silber - ***BMO Capital Markets - Analyst***

Okay, great. And are there any more of these type of payments on tap for prior acquisitions?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, in the range we gave, the $30 to $40, that is the totality of the acquisitions.

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Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. And also just a follow-up on Europe, I know you had mentioned it and you can see it in the results that you're really leaving a lot of lower margin business. How much longer is this weaning going to be going on?

Jon Chait - *Hudson Highland Group, Inc. - Chairman and CEO*

I would say it's hard to say, Jeff. You know, and because it's a process, you know, over time. And things that looked, you know, decent a year ago now to us look low. And if you look at and just looking at the U.K. industry, you know, the IT business is a business that has much lower margins, our competitors report much lower contracting margins, as well. It has much lower margins than say the accounting and finance business.

We're certainly not going to exit the IT business but we're being very selective about the kind of business that we take on in contracting in IT and our team, I think, in the U.K. has done an excellent job migrating their business to higher margins even within IT. At the same time, we've invested a lot of resources, a lot of management time, a lot of management talent in growing our accounting and finance business in the U.K. market. Again, you know, we've been very pleased with the success that that team has achieved in the last couple of years. So, you know, I would say, you know, I'd have a hard time putting a specific number on it because I think it's an evolutionary process.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, that's fair. Actually, I've got a bunch of numbers questions. Maybe you could help us out in terms of the guidance to give us a little bit more color by region in terms of the revenue line? And also what type of gross margins are you expecting to hit the adjusted EBITDA number that you're forecasting?

Mary Jane Raymond - *Hudson Highland Group, Inc. - EVP and CFO*

Well, let's see, let's -- first of all, Jeff, let me answer, fix one thing I just told you before, the $30 to $40 which includes the acquisitions, all of them, first of all, is this year. But included in that number for this year, because there probably will be some earnouts next year. One large acquisition that was done or acquisition done several years ago, this is the last year. So I wouldn't expect to see $30 to $40 million repeat next year, so just to clarify that on this year's earnout payments.

With respect to then your question about color by various regions, I think in general I would expect that we would see kind of a continuation of the same growth that we're seeing across the world at the present moment. Q1 can be a little bit tough to tell, and as people do their forecasts for second and third quarter they tend to not vary too widely from that, so generally speaking that would be my sense, that it's roughly the same as we saw, as we're seeing sort of right now.

With respect to gross margin, obviously, the Company's gross margin as we look at this quarter, I don't know that I see that materially changing as we go into the second quarter in terms of pattern against, well, maybe not pattern against prior year because we obviously had a pretty weak comp last year. But I'd say generally speaking we should see a gross margin, you know, be a little stronger in second quarter than we thought, than we had in Q1, which is pretty typical of the pattern we have. And as a result from that and also getting some of the social payments, the Social Security payments out of the way in Q1 which is also our typical pattern, we would expect to see a bit of a pick-up in North America from -- because Q1 is their lowest EBITDA by far.

So generally speaking I think Europe will follow it's normal pattern of a strong Q2 and a strong Q4, and I expect Asia-Pacific to follow their realtive pattern of a strong Q2 and Q3, relative to Q1. And in North America's case they're also going to be up against a weak comp from last year, but I expect the momentum they have in Q1 to continue into the second quarter.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, that's helpful. Again, a couple of quick numbers questions. The $6.2, $6.3 million in corporate expenses, is that roughly the rate we should be expecting going forward?

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Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

I'd say roughly about maybe $6.5 to $7.

Jeff Silber - ***BMO Capital Markets - Analyst***

Okay, great. And I hate to go back to taxes, but a couple quick tax questions. The, the gain on sale that you recorded, what was that net of taxes?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

The gain on sale net of taxes is roughly, let me just find that for you -- probably about $1.8 million.

Jeff Silber - ***BMO Capital Markets - Analyst***

Okay, great. And just to clarify one thing that you had said about the U.K. tax rate going forward, the 30% rate for the U.K. -- I'm sorry, did you say that that's something we should be expecting starting in the fourth quarter of this year? Did I hear that right?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

No, sorry.

Jeff Silber - ***BMO Capital Markets - Analyst***

Okay.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

We should be expecting that really from more or less the first quarter. In the fourth quarter of '06 we completed the use of a net operating loss carry forward in the U.K. Business, vis-Ã-vis Jon's earlier comment, which has done well in changing their mix has generated some reasonable income for us, notwithstanding, we'd like it to be even stronger. So commencing this year we'll have a more normalized tax rate on the U.K. income.

Jeff Silber - ***BMO Capital Markets - Analyst***

Okay, that's helpful. I'll let somebody else jump on. Thanks, again.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Sure. See you.

Operator

[OPERATOR INSTRUCTIONS.]

Your next question comes from the line of Mark Marcon.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

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Hey, Mark.

Operator

Your next question comes from the line of Mike Carney.

Mike Carney *- Aperion Group, LLC - Analyst*

Hey, good morning.

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Hi, Mike.

Jon Chait *- Hudson Highland Group, Inc. - Chairman and CEO*

Hi, Mike.

Mike Carney *- Aperion Group, LLC - Analyst*

First, on the top line growth in Asia, what was that either revenue or gross margin or something year-over-year?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Let's see, hold on a second. From a top line perspective the revenue growth was in round numbers around 9%.

Mike Carney *- Aperion Group, LLC - Analyst*

Okay. And then, Mary Jane, how confident are you that the restructuring is done for this year? Is it 90% or 99% or?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Let me explain it to you this way, first of all, the restructuring program we put in place for last year, which I think we, indeed, completed in the first quarter, was actually targeted at having a step function reduction in the spending. And so from that perspective I consider that that's done. We have instilled and my colleagues have done a wonderful job in thinking through ways to just be more effective in their spending going forward.

The reason I sort of give you something of a qualified answer here is we also, as was noted, look to over time to divest roughly 10% of our revenue, which is $140 million. Part of the reason we want to do that, well there's two: one, it's not really the business we want to be in, and the other thing is having businesses of that size lock in overhead. And so the one thing I would tell you as we progress with the sale of a lower margin business, I do expect that that will come with a plan that will also tackle the overhead associated with those businesses so that we can realize the full potential of then being in higher margin businesses. So in a nutshell the 2006 program is done.

As we look at the divestiture of the 10% of the remaining non-core, I do expect that that will come with our also looking at the overhead that is supporting that and understanding either how to send that with the business, reduce it or redeploy it in a way that helps advance the EBITDA of the Company.

Mike Carney *- Aperion Group, LLC - Analyst*

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Okay, great. And in terms of selling the 10% you said the next few quarters, is that, you really expect to sell those businesses, you know, all 100, all 10% in the next few quarters probably?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, you know, you're asking me to reveal my secrets vis-Ã-vis the conversations we have internally. What we have done as an organization is to be very clear about the businesses that notwithstanding they are good businesses, run by very good people and operated internally by very good people, are not core. But these are lower margined businesses, and you know as well as I do how those tend to go. They are very attractive businesses to the right buyer, and we're fortunate that we will send, you know, well running businesses with a good team.

But the fact remains that the timing around those are unpredictable. We're not selling Microsoft here, so, you know, I would say that our focus as a Management Team is to be on with doing this. But being able to say it'll all be completed by, as an adjective, September 30th, that is obviously impossible for us to predict, but I'd say we're pretty focused on trying to get it done.

Mike Carney - ***Aperion Group, LLC - Analyst***

Okay. And then, also, I know you're not -- I know you don't want to talk about the valuations, but are -- is it still reasonable to assume that the, you know, the valuations are lower than the valuation you have now?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Yes, I think Jon did a very good job the last time explaining not only vis-Ã -vis the nature of those businesses but also, you know, they're lower growth, they're lower margins, but I do think they will be in the lowish multiple range.

Mike Carney - ***Aperion Group, LLC - Analyst***

Okay. And then in terms of the corporate expenses in the first quarter, was there any bonus accrual to Management?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Yes, the bonus accrual is normalized in the first quarter across the board.

Mike Carney - ***Aperion Group, LLC - Analyst***

Okay. And then in the $6.5 to $7 million going forward, that would also include the bonus accruals for Management?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

It does.

Mike Carney - ***Aperion Group, LLC - Analyst***

And then one last question on the, the earnout, for example, JMT since the Financial Solutions business is down, does that mean that there's a good possibility that the earnout is going to be lower, too, unless that picks up again?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, obviously, the earnout formulas, we won't speak about them by specific acquisitions, are based on the earnings of the business that those leaders drove. In some cases we combined offices to those we had, in some cases it stays as their own. I would say that just to reiterate the

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earnouts will be commensurate with their performance and commensurate with the agreement that we had. My own sense, again, we're a little bit early, well, not that early, but we're beginning to kind of really focus on exactly these numbers, whether it's JMT or anything else, their earnouts are very consistent with what those leaders have produced and contributed to our Company.

Mike Carney *- Aperion Group, LLC - Analyst*

But it's, it's ongoing, I mean it would include results from this year, right?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

It does include results from this year. I can't exactly, I mean to be quite precise, I think we did that roughly middle of the year, so the 12 months, probably would include the last 6 months, the last year, and the first 6 months of this year, something like that. It goes on the anniversary of the acquisition.

Mike Carney *- Aperion Group, LLC - Analyst*

And the Financial Solutions practice that's down is that, is that all of finance and accounting, or is that just the higher end Financial Solutions?

Jon Chait *- Hudson Highland Group, Inc. - Chairman and CEO*

It's all of -- it's the whole thing, all of finance and accounting.

Mike Carney *- Aperion Group, LLC - Analyst*

Okay. And then on, on Tony Keith, last quarter I think you said the consideration was $5 million for that?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Right.

Mike Carney *- Aperion Group, LLC - Analyst*

That doesn't include the earnout, right?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

It doesn’t include the earnout.

Mike Carney *- Aperion Group, LLC - Analyst*

Okay. And is that also earnout that is, could be large depending on how well they do?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Well --

Mike Carney *- Aperion Group, LLC - Analyst*

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Or might -- I guess I could rephrase that, is much larger than the initial consideration?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

I don't know that I'd describe it as much larger. Obviously, you know, all in inclusive of how we might see the earnout going, we're still trying to stay in sort of a 5 to 7 multiple range. So --

Mike Carney *- Aperion Group, LLC - Analyst*

Over the three to five-year period?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Right, inclusive of the initial payment.

Mike Carney *- Aperion Group, LLC - Analyst*

Okay, thank you.

Operator

And your next question comes from the line of [Ty Govatos.]

Ty Govatos – *CL King - Analyst*

Hi. And, by the way, congratulations on the quarter.

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

Thank you, Ty.

Ty Govatos – *CL King - Analyst*

A couple of small ones. Wasn't there a tax affect on the $3 million restructuring?

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

In other words, is it tax deductible?

Ty Govatos – *CL King - Analyst*

What was, what was the net after-tax? Another way of wording it.

Mary Jane Raymond *- Hudson Highland Group, Inc. - EVP and CFO*

So what is the after-tax affect --

Ty Govatos – *CL King - Analyst*

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Affect of the restructuring?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Let me just get that for you. Why don't you ask me your next question? I'll pull that up for you.

Ty Govatos – ***CL King - Analyst***

PeopleSoft, can you give us any kind of a feeling for the magnitude of the current expenses?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Yes.

Ty Govatos – ***CL King - Analyst***

And then to refresh us what they were a year ago, and how fast they're coming down?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Sure. Okay, so, the expenses in the first quarter were about $1.1 million. The expenses last year in this quarter were about $2. So you'll remember in the beginning of last year we were looking at a run rate that would take us across the year at roughly about $8 million and where we came in, was roughly about $7. So effectively in the program that we put in place, we're running at roughly half the expense rate that we were seeing last year. And I think without a doubt with better efficiencies and value guidance work being done in the back office of North America.

Ty Govatos – ***CL King - Analyst***

Will most of those be squeezed out by the fourth quarter?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, first of all, with respect to the program, you know, the remediation program --

Ty Govatos – ***CL King - Analyst***

Right.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

-- we are expecting to conclude that toward the end of the second quarter, you know, maybe a week or so into the beginning of the third quarter.

Ty Govatos – ***CL King - Analyst***

Uh-huh.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

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So that on the program, itself, probably another twoish million dollars to one-and-a-halfish to two this year. And then what will happen is we expect to see kind of ongoing run rate costs for just the general maintenance of the system. It does run the whole back office, and I would see those in the range of $500,000 to $700,000 on a running basis a quarter.

Ty Govatos – ***CL King - Analyst***

Okay.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

So just to come back to your, your question --

Ty Govatos – ***CL King - Analyst***

Tax affect, yes.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

With respect to the U.K., the charges on the U.K. would be tax deductible, and so we would expect to have about $700,000 tax yield on that, if that's your question?

Ty Govatos – ***CL King - Analyst***

Yes, okay.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

And then in the U.S., the charges that we have in the U.S. are not tax deductible but they're also relatively smaller, about $700,000.

Ty Govatos – ***CL King - Analyst***

Okay. So basically $700,000 against the whole $3 million?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Yes.

Ty Govatos – ***CL King - Analyst***

Thank you very much, and, again, great quarter.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Thanks.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Thanks, Ty.

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I think we have time for one more question before concluding remarks.

Operator

Okay. And your next question come from the line of Sean Connolly.

Mark Marcon - ***Robert Baird - Analyst***

It's Mark Marcon. Congratulations on a good quarter.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Hey, Mark. We were afraid we lost you.

Mark Marcon - ***Robert Baird - Analyst***

Yes, yes, telephone problems. Wondering with regards to your line, your credit line, can you refresh us in terms of what the current terms are and how much availability you have?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Right. So we have a credit line of $75 million which is secured against the receivables. As a general matter, our letters of credit are initially deducted off that which are running at about $9, $10 million. We have $5 million, as I said, outstanding on the revolver at the end of Q1, and because our line of credit is secured against the receivables we are experiencing a funny sort of thing, which is as we get better at DSOs, the receivables are coming down. So I'd say at this point we have somewhere between $47-$50 million availability on the revolver. So if you take the letters of credit at $10, the borrowing standing of $5, you know, it's roughly in the $70 range.

Mark Marcon - ***Robert Baird - Analyst***

Yes, and then what's your expectation for free cash flow for this year, roughly speaking?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, again, you asked me this last time, and you are asking me our internal secrets. I, first of all, as we did achieve, last year my goal was to actually get the Company to breakeven cash flow.

Mark Marcon - ***Robert Baird - Analyst***

Uh-huh.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

And having done that, we have set a target internally for the organization, and my goal would be that as a rough directional number I would like the free cash flow to approximate the EBITDA for the year. So I'd like to move it upwards of, you know, $30, $40 million by the time we're done. I'm not giving you guidance for the year, I'm just saying it --

Mark Marcon - ***Robert Baird - Analyst***

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Yes, so I mean, based, based on those two factors, it seems like if, like you indicated earlier, if you wanted to use cash in order to pay-off the earnouts that seems like a, quite a viable option?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

I do think it is. I mean obviously sometimes some of you ask me what we're going to do with all our cash, and just upon being in a positive cash flow position I'm not so inclined to think it's oh, so much. So I mean witness why my comments about this are somewhat cautious, but, yes, I do think it actually is a viable option and that's why we're not committing on the percentage of cash or stock. I always try to make this as least dilutive as possible.

Mark Marcon - ***Robert Baird - Analyst***

And you can do a combination, as well, can't you?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Oh, yes, sure.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Yes, absolutely. Mark, also, obviously, I'm sure it's obvious, but the reason to state the obvious we talked about the payments coming in the third quarter, so there's a point in time at which we have to make a judgment.

Mark Marcon - ***Robert Baird - Analyst***

Sure.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

And the balance, you know, I think what we're trying to signal to you is we have listened to our shareholders. We get the message that they're very concerned about dilution, that's very well understood, and what we have to evaluate is, you know, to what extent do we want to pre-commit our financial resources that we might not have at just that moment to fund earnout payments. So it's a balance, and what we're trying to signal to you is that we have listened to shareholders, [inaudible].

Mark Marcon - ***Robert Baird - Analyst***

Great. With, with regards to the performance by regions, you wouldn't happen to have kind of an organic proforma revenue number so that we can, because obviously you've made a number of divestitures, and so if we were looking at it on an apples-for-apples basis on a constant currency basis, you wouldn't happen to have that, would you?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, I guess the simplest thing is to just remind you from a revenue point of view that if you look at the revenue growth we've reported it roughly 3%. Last year in 2007 we had $5.7 or roughly $6 million in the prior year. So I think that probably gives you enough to do the math.

Mark Marcon - ***Robert Baird - Analyst***

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Okay. All right. Great. And then with regards to, with regards to your IT Division in general the performance was quite encouraging. IT seemed like it was soft relative to what we're seeing out of some of the other players. Can you describe, you know, how you're coming along in terms of stabilizing that business, and help with monthly trends?

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

You're talking about North American IT?

Mark Marcon - ***Robert Baird - Analyst***

Right.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Yes. I think what we've seen in the business is since Tim Bosse was appointed as the practice, what we call the practice leader, the EVP of North American IT, Tim has done a very good job of putting the management team in place, and I think will drive us to success. I think we have a stable team, and the business has been broadly, you know, was declining when Tim came in and has been stabilized both at a revenue level and at a gross margin level.

I think my attitude is, you know, to try to curtail my impatience and, you know, simply let Tim have time to work, and I think he's doing a good job. I think we have a good team on the field, and I think they'll be successful. Obviously, I look at all the other earnings releases, and I see that we have not been as successful and we were not as successful in the first quarter as many of our competitors, but I look at it, admittedly as to the glass being half full. I think it gives us a good opportunity in the coming quarters to do better.

Mark Marcon - ***Robert Baird - Analyst***

Okay. But things have stabilized on a monthly basis, your consultant accounts --

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

Yes.

Mark Marcon - ***Robert Baird - Analyst***

-- are starting to, to flatten or trend up slightly on a monthly basis?

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

I'm always cautious about saying trend up until I can report to you that the trends were up, but that's a personal philosophy. I think clearly the business has stabilized. The thing that I think is most important is that we have the right team on the field, and ultimately, you know, as I mentioned that, and I think you know Mark, that's the thing that will drive success.

Mark Marcon - ***Robert Baird - Analyst***

Yes.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

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And when you have the right team on the field they'll be successful over time. You know, the -- there's a famous person once said, you know, "It takes 18 years to make an 18 year old." And it takes some time to let people get into the rhythm of jobs and a lot of the people in our IT organization are pretty new in their positions, but I think from my standpoint that's a business that I think is well positioned.

Mark Marcon - ***Robert Baird - Analyst***

Great. And then a last question just on, just a clarification from Ty's question on PeopleSoft, the $1.1 million for Q1 that was spent, was that just purely for the remediation or does that also include the kind of ongoing maintenance of $500 to $700?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

I'd say that's probably the combined number.

Mark Marcon - ***Robert Baird - Analyst***

The combined number. And the $1.5 to -- so you mentioned that the remediation cost was going to be $1.5 to $2 million, if the Q1 number was the combined cost, does that mean that the remediation number is going to be higher in the second quarter?

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

Well, first of all, just to clarify, so thanks for the question, I mean those to be kind of apples-to-apples. I don't mean that add the remediation cost on top of $5, first of all.

Mark Marcon - ***Robert Baird - Analyst***

Okay.

Mary Jane Raymond - ***Hudson Highland Group, Inc. - EVP and CFO***

The second thing is that the way, that said, the $1.1 to roughly $1.5, $1.6, I do think it'll be a little higher in the second quarter because this phase, the second phase we're going through, it's a little like groundwork being laid obviously in the first quarter. What happens in the second quarter is not only do they start to bring some of those enhancements online they also start training the people to do them, so there's a little bit of a combination of finalizing the program, working it to finalizing the training. But net, net I mean for those two numbers to be comparable, as I describe between Q1 and Q2, and also compared to last year.

Mark Marcon - ***Robert Baird - Analyst***

Okay, great. Thank you very much.

Jon Chait - ***Hudson Highland Group, Inc. - Chairman and CEO***

With that, thank you very much for your attendance today. We'll be available at the usual places and times, and I'll turn it over to David for closing remarks.

David Kirby - ***Hudson Highland Group, Inc. - Director of Investor Relations***

Thank you, Jon. And thank you, everyone, for joining the Hudson Highland Group first quarter conference call. If you do have any further questions, please feel free to contact Mary Jane Raymond, or myself, at any time. You can reach Mary Jane at 212-351-7232, you can reach me at 212-351-7216.

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