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Conference Call Transcript

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PRESENTATION

Operator

Good morning. My name is Lynn, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Hudson Highland Group Third Quarter Earnings 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 period. If you would like to ask a question during this time, simply press "star" then the number "one" on your telephone keypad. If you would like to withdraw your question, press "star" then the "two" on your telephone keypad. Thank you.

I will now turn the conference over to Mr. David Kirby, director of Investor Relations. Please go ahead, sir.

David Kirby - *Hudson Highland Group - Dir. IR*

Thank you, operator. Good morning, and welcome to the Hudson Highland Group conference call for the third quarter of 2005. I am David Kirby, Director of Investor Relations for Hudson Highland Group. Our call this morning will be led by Jon Chait, chairman and chief executive officer, and Rich Pehlke, 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.

I will now turn the call over to Jon Chait.

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

Thank you very much, David. And thank you very much, ladies and gentlemen, for joining us today. As has been our custom in past calls, I'm going to start off today with some comments on significant trends within our business. And then I'm going to turn over to Rich Pehlke, our executive vice president and chief financial officer, who will discuss the results in more detail. After Rich's presentation, we will open the line for a Q&A session.

The third quarter of the year is traditionally a seasonally soft period. That's because of the summer holidays, particularly in the Northern Hemisphere, which accounts for about 2/3 of our revenue base. And the summer holidays have a particularly dramatic negative impact on permanent recruitment, which accounts for more than 50% of our revenue base.

Nevertheless, in view of those factors, I can only characterize the company's quarterly results in the third quarter as excellent. They were driven by significant improvements in operating unit profitability over the year ago period. During my remarks, I will, from time-to-time, refer to EBITDA, which I'm sure most of you know, means "Earnings before Interest, Taxes, Depreciation and Amortization."

Consolidated revenue increased by 13% in the quarter over the same period in 2004, while gross margin increased by 16% on a constant currency basis, which we believe is the best measure of underlying operating results. Revenue increased 12% and gross margin increased 15%. Consolidated EBITDA was $8.7 million in the quarter compared with a loss of $2.4 million in the third quarter of 2004, or an improvement of $11 million.

I'm going to just take a moment to comment upon the quarterly results. Since the spin-off from TMP, the management team has focused relentlessly on improving the profitability of our business lines, which has included the shutting or exiting of unprofitable operations, relocating out of expensive premises and rightsizing our operations. While certainly we're happy with the revenue growth overall in the third quarter, we have to point out that some of the revenue growth in the high margin core lines of business has been offset by those actions.

Our objective has been to build a sustainable and profitable business. Our internal litmus test has focused on EBITDA as a percentage of revenue. And the third quarter marks another strong period of improvement on that basis. Later in my remarks I'll comment on the improvements on a regional or country level basis. But first, let's take a look at the core -- at the consolidated results.

On a consolidated basis, EBITDA for the quarter was 2.4% of revenue compared with negative 0.8% in the same period of 2004. Year-to-date, EBITDA, as a percentage of revenue, stands at 2.1% with the historically strong fourth quarter remaining. This compares favorably to our 2005 goal on the high side of reaching 2%. This also represents solid progress towards the company's long-term goal of achieving 7% to 10% EBITDA margins on a normalized basis.

The third quarter results demonstrated the positive impact of operating leverage. Of the $17.4 million increase in consolidated gross margins in constant currency during the quarter, $10.6 million or a 61% drop to EBITDA. We've announced the 2005 target to return 25% to 50% of the increased gross margin dollars to EBITDA, so in the quarter we were significantly over the high end of that range.

On a constant currency basis, expenses were up only 5.7%. Expenses in the third quarter declined to 35.5% of revenue from 37.7% in the year ago period.

While every regional operating unit contributed to the third quarter results, there were some noteworthy achievements. Hudson AsiaPac EBITDA, as a percentage of revenue, reached 7.6%. Hudson Europe EBITDA, as a percentage of revenue, reached 3% compared to a loss in the year ago period. Hudson North America continued its strong growth with revenue up 31%, and reported EBITDA, as a percentage of revenue, of 4.7%.

Highland Partners continued its strong recovery with EBITDA as a percentage of revenue reaching 10.1% for the quarter. Hudson U.K. is an excellent example of the positive impact achieved in the quarter in shifting the mix of business, as I mentioned earlier in my remarks.

I just want to take a moment to comment on that specific operating unit. Temporary revenue in the U.K. increased only 2% in local currency in the third quarter. Our temporary gross margin, however, increased 31% as a result of exiting low margin contracts and service lines and focusing on higher margin business.

Similarly, in Continental Europe, permanent recruitment revenue increased only 5% in the quarter. But HCS revenue, human capital consulting, which is a foundation of our Continental European operations focused on talent management in Europe, once again reported a strong quarter with good growth and expanding margins.

Hudson North America achieved the largest growth of our operating units with revenue up 31% and gross margin up 27% compared to the third quarter of 2004. That unit's success was fueled by strong gross margin growth on a year-over-year basis in the core business lines of legal, which was up 57%, accounting and finance also up more than 50%, and engineering and aerospace which is up more than 100%.

On a sequential basis, revenue increased in North America 1% in the third quarter compared to the second quarter of 2005, while gross margin increased 4%. Gross margin increased sequentially over 40% in engineering, aerospace and defense, 11% in accounting and finance, but was down 3% in legal as a result of a comparison against a very strong project that was in the second quarter earnings, and down 7% in the IT sector.

North America achieved $5.1 million in EBITDA, up 155% from $2 million in the third quarter of 2004. However, even after adjusting for a restructuring charge in the year ago period, EBITDA still improved 69% compared to the prior year, and reached 4.7% of revenue compared to 2.2% in 2004. The North American unit returned 51% of the increase in gross margin dollars to EBITDA. Hudson North America's temporary gross margin remained essentially flat at 21.3% compared to 21.4% in the second quarter of 2004.

As I mentioned earlier, Highland Partners continued its solid turnaround with revenues up 8% in the quarter, but with EBITDA reaching $1.6 million compared to a loss of $2.1 million in the year ago period. The year ago period included a charge of $2.6 million related to the relocation of the Toronto office. The results in this quarter were still considerably improved even after adjustment for the charge.

As I mentioned, Highland Partners achieved an EBITDA, as a percent of revenue, of 10.1% in the quarter, its highest margin to date, and all three segments -- all three geographic units of the Highland Partners organization reached profitability. We reported consolidated net income for the quarter of $2.3 million. On an earnings per share basis, we reported positive earnings per share of $0.10 per share on basic earnings per share and $0.09 a share fully diluted.

I want to comment just generally on two other items. One is our guidance, and Rich is going to talk specifically about our guidance. But I want to point that today -- well, yesterday in our press release, we announced an increase that we are raising our guidance for the full-year 2005 and by implications for the fourth quarter of 2005. We also reiterated our guidance for 2006.

We consider that an optimistic outlook for our company in 2006 because we think the economic outlook on a macroeconomic basis for the world has declined in the last 3 months. Nevertheless, we continue to reiterate our outlook for 2006 based on our margin expansion. Rich will -- as I said comment more directly on that.

Finally, I'd like to close today by announcing that we have successfully completed our search for a new CFO. The Board has elected Mary Jane Raymond, former chief risk officer of the Dun & Bradstreet Corporation, as executive vice president and chief financial officer, effective December 1st. As previously announced, Rich will be leaving the company and its Board at year end, but he will serve as a consultant through 2006 to help ensure a smooth leadership transition.

I am very happy to have Mary Jane on board. I think she brings extensive finance and controllership experience in addition to risk management and strategic planning expertise from her tenure at D&B, Lucent Technologies and Cummins (ph). You can obtain all of this information and more in the press release which is being issued simultaneously with our call this morning.

With that, I will turn it over to Rich for more detailed comments on the financial statements.

Rich Pehlke - ***Hudson Highland Group – EVP & CFO***

Thanks, Jon, and good morning, everyone. As I usually do, I'll start out with talking about the currency impact on the quarter and on the sequential quarter results. Sequentially, currency fluctuations had very low impact on the overall results. It actually -- in constant currency revenue and gross margin on sequential basis just declined very slightly. Expenses were basically flat and EBITDA was down sequentially about $2 million. And we think about the fact that our second quarter is one of our strongest quarters, it reinforces all the points that Jon made about the strength of our operations in the third quarter, which is seasonally a very soft one.

Year-over-year, very much the same in terms of impact and currency, very minimal impact caused by revenue between the reported and constant currency results, which was usually about a 1% to 2% difference in the revenue and gross margin increases. In both cases, revenue and gross margin were up and well into the double-digits. And on an EBITDA basis, virtually about a $400,000 difference and between the reported results, variance versus constant currency. So again, minimal impact in currency, which has been relatively consistent with our historical pattern.

It is important to note though, and Jon touched on this in his remarks, and I can only reemphasize because I think it is the strength of our story right now, that with the strong increases in revenue and gross margin that we have been experiencing, the expenses have still remained in control. Our non-salary and related expenses increased 25.8% in constant currency and our salary and related costs were 9.5% increase – that reflects the growth in our business. As we've said many times, that's where we'll experience the higher expense growth largely because of the incentive compensation plans that are so prevalent across our operations. Nevertheless, we still maintained excellent operating leverage. Jon touched on this, but in the quarter, it was 61%. It was above our stated target and excellent performance overall by all our business units.

We continue also to see the trend of our non-salary related G&A cost fall as a percentage of revenue. That is a trend that we are constantly monitoring and due to both the growth in the business as well as excellent expense control.

In depreciation, we continue to expect depreciation and amortization to be about $18 million for the year. You'll note in our balance sheet that the intangible assets rose considerably during the quarter reflecting the acquisition of Balance, our contract staffing business where we closed the acquisition this quarter. The quarterly results included about 6 weeks of activity from that operation.

We do expect that some of these assets will be amortized. We are currently in the process of finalizing all that with our accountants and our auditors, but we do not expect that to change in any way our outlook for the year of where our depreciation and amortization will fall. So we're still very comfortable with that number. On CapEx, CapEx for the quarter was 2.9 million and year-to-date, it's 8.3 million. Again, very much online with our stated objective of that number being between 10 million and 12 million. So again, our CapEx remains right on target.

Let me turn to our taxes for a moment on the income statement. We continue to have large tax loss carry forward positions. Overall, its total value is almost -- just under 300 million now. It was an estimated deferred tax asset value of 106 million and it is not on the balance sheet. The U.S., the U.K. and Europe represent a good portion of that number. We also have tax loss carry forwards in our New Zealand operation as well. But we do pay taxes in Australia and in Asia, and we also pay taxes on our new acquisition in the Netherlands. As a result of that, our effective tax rate on our income statement still remains high, because of our overall profitability position and the contribution from the regions I mentioned to that position. So, for the quarter, our effective tax rate was high at 40% and it was 68% year-to-date and that explains why that is.

Turning to rest of the balance sheet. We've finished the quarter with almost $34 million in cash. Our accounts receivable grew. We've had $43.5 million of growth in accounts receivables since the beginning of the year and just over half of that amount now results in the third quarter. The quality of our portfolio continues to remain excellent and as we've said repeatedly in the last few quarters, bad debt expense within our operations is not a major issue. We have strong credit and collections policies and we monitor that closely. However, we did experience in the quarter some slippage in our working capital ratios both in North America and Europe. Our DSO did rise to 58 from 52. Part of this is growth related. But some of this is also due to something I will comment on in a moment.

When you look at our growth in receivables since the beginning of the year, about 15% to 20% of that growth would be due to an issue that I'll comment on very shortly. Before I do that, though, let me just cover our debt position. Our short-term debt was about 25.8 million. Again, we used our debt to fund the growth in our business. It is a credit facility supported by our receivables and it helps us manage our working capital, and we believe that the position of our facility, which is an overall value of 75 million, we currently can access just under 70 million of that due to the size of our portfolio. And we have adequate resources between that facility and our cash to meet our needs.

To get back to the DSO and receivable growth issue for a moment, in our North American operation, over the past few years, you've heard Jon and I comment many times that we've needed to address the support systems in our business to meet future demand. This is obviously an area that we have signaled for very strong growth in the months and years ahead.

During the third quarter, we implemented new financial management systems in North America. As is typical in an exercise like this, we experienced some problems that, for a short time, affected our ability to issue financial management reports and invoice customers on a timely basis.

Usually that was in the first 2 months of the quarter. To give you an example, it was probably running 3 to 4 days delay. One result of this is that we experienced an increase in our receivables, both built and un-built. This is reflected on the September balance sheet, as I indicated earlier. However, our people have been working diligently to resolve these issues and as we approach the end of October, we are well on our way to returning to the normal levels by the end of the month.

Let me also ensure our investors that we've taken extra steps and analysis to ensure the accuracy and integrity of our reported results through this period. Some of these actions have included additional checks and balances, reconciliations, additional control procedures, analytics, process changes and training for our people to adequately get the new systems in place and return to normal pace of operations.

Finally, I will talk about our guidance. As we've stated in our press release, given the current economic environment, the company expects EBITDA as a percent of revenue to be at least 2% in 2005 and believes that an assumption of 12% to 15% revenue growth for 2005 remains reasonable. Considering the strong year-to-date results and the impact of the Balance acquisition, the company now expects 2005 full year EBITDA to range from $30 million to $34 million. This is based on expectations of constant currency revenue and gross margin growth of 30% to 35% in Hudson North America, 10% to 15% in Hudson Europe, and 0 to 5% in Hudson Asia Pacific and Highland Partners.

We continue to expect EBITDA as a percent of revenue to be 3.5% to 4% in 2006, and we believe revenue growth assumptions above 10% at this time for 2006 would be unreasonable, as Jon outlined earlier. Our long-term goal remains to achieve sustainable EBITDA margins of 7 to 10%.

And with that, I think we are ready to open it up for questions.

QUESTION AND ANSWER

Operator

At this time, I would like to remind everyone if you would like to ask a question, press "star" then the number "one" on your telephone keypads. We'll pause for just a moment to compile the Q&A roster.

Our first question comes from Matt Litfin of William Blair and Company.

Matthew Litfin - *William Blair & Company - Analyst*

Hi. Good morning and congratulations on the quarter.

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

Thank you, Matt.

Rich Pehlke - *Hudson Highland Group – EVP & CFO*

Thanks, Matt.

Matthew Litfin - *William Blair & Company - Analyst*

A question on North America. The engineering piece of your staffing business – it looked like it had a solid quarter. How much did the solid revenue quarter there contribute to the year-over-year decline in gross margin in Hudson North America?

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

This is our -- what we're talking about in that comment, Matt, was what we call our Engineering, Aerospace & Defense Group, which is a relatively high margin group. The margins are consistent with our other high margin businesses, like IT, Legal, and a little less in Accounting & Finance. So it probably had a bit of just a change in mix. It probably had a bit of an impact. I'll let Rich or David comment specifically on the numbers. But we're talking about Engineering, Aerospace & Defense rather than our lower margin Engineering/Nuclear Engineering business. I don't know. Dave and Rich, do you have any comments on that?

Rich Pehlke - *Hudson Highland Group - EVP & CFO*

I want to make sure I understood the last part of your question, Matt. Were you talking about an increase or decrease in the gross margin?

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

Gross margin was flat. But I think -- I thought what Matt was asking was that revenues were up 31%, and gross margin was up 25%.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Right.

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

Is that what you are talking -- is that basically -- did I have that right, Matt?

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

Yes. And the question was answered when you -- explained that the Nuclear Engineering (inaudible) --

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Rich Pehlke - ***Hudson Highland Group - EVP& CFO***

Yes.

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

-- was separate. I was thinking that those were the same things.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Okay. I thought you did, but I just wanted to make sure we got it.

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

Thanks. How satisfied are you, Jon, with your mix of business, as it stands today? Are you happy with the countries and offices that you are in or do you feel like you still have some ways to go to divest more unprofitable or zero margin revenue in order to make that 3.5 to 4% EBITDA margin guidance for next year?

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

There are certainly some pieces that we are going to be very careful. The way I look at it, Matt, is we want to expand in what we think of as our core business and service lines – the higher margin lines. Then there are other pieces that we just don't want to expand. We will hold them, we will run them, they make cash, they contribute to the business. And then there are pieces that we want to exit. All that blends into our revenue mix.

I would -- off the top of my head, I think, that we are mostly done with the major pieces that we want to exit, which are basically contracts and service lines. And I mentioned particularly some of that activity occurred in the UK in the last quarter. So I'd say, in that sense, we're done with the exits more or less. I think we have -- certainly, in terms of looking at our overall mix of business, we have areas of the world where we can do better, and we have an opportunity -- I think, a great opportunity -- to do better in many areas of the world. So in that sense, I guess I'd say I'm unhappy. But I think, unhappy is tempered by the fact that we've made a huge amount of progress. But I think we still have a great opportunity.

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

Sure. And then the last question I have is, what have been the business trends here in October as compared to the run rates you experienced in Q3 in whatever way you measure that?

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

No change. Yes, we haven't seen anything that would indicate that things are off track at all.

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

No, there's really no change at all.

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

Okay. Thanks. And, Rich, if this ends up being your last conference call, thanks for the work you put into the company over the past 3 years.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Thanks, Matt.

Operator

Your next question comes from Avi Fischer of Harris Nesbitt.

Avi Fischer - ***Harris Nesbitt - Analyst***

Hi, good morning. Thanks for taking my call. Given that you're not economists, but you didn't talk about the macro environment for '06 and I was wondering what made you fell the way you do about the '06.

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

One of the things particularly that's in my mind is that the economic growth forecast in the European Union have been reduced significantly in the last quarter. The economic forecast for the EU from the OECD and the Economist is now below 2% for next year, and the forecast for the U.K. specifically has been reduced. So if you look at forecasted growth in '06 as reduced compared to the growth that was actually experienced in the first half of '05, there is at least a 1 percentage point difference negative. So that's one issue.

The second issue is that I think in the U.S. economy, there are a lot of cross currents, but whether it's a price of oil, hurricanes or other things. I think that the economic environment is not as strong today as people -- the perception of the economic environment for 2006 is not as strong today as people thought 3 months ago. Finally, in Asia Pac I would say the economic perception is down a tad, not gigantically, but down a tad.

Avi Fischer - ***Harris Nesbitt - Analyst***

Alright. I appreciate that. The projects that you got in North America – legal, accounting, finance, engineering, aerospace – could you characterize the projects? I know last quarter you mentioned this. Have you had a short-term project in legal? Are the projects in legal -- the legal, accounting, finance that you have -- would you characterize as long term or short term or --

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

Yes, we were -- we had a happy experience in the second quarter of having a very short-term project, where we deployed about 400 lawyers in an M&A assignment during the second quarter that peaked in the second quarter. So I don't actually know off the top of my head how many of those lawyers, if any, are still working on that project, but if there are any working, it's dramatically down. So it's one of the happy things that happens in our business.

And from a business perspective, it's great; from a finance and accounting perspective, it's a nightmare because we had a huge positive win that was a success in the second quarter. We helped the client. It's a very high profile situation in the business. And yet, obviously, when we look at sequential growth of the third quarter, we don't have it. So that makes it a little more of a challenge and actually, our team did a phenomenal job of, you know, filling up the bucket, so to speak. So hats off to them.

Avi Fischer - ***Harris Nesbitt - Analyst***

Alright. I guess the question is in Q3, are there similar one-time short- term projects or are a lot of these the growth from long-term projects?

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

It's hard to say in our business because so much of our business is project oriented. There isn't anything like that particular project. But, so much of our business is specific project oriented that -- and that's basically the demand that drives our business. That's the wonderful thing about our business is that people need us as an industry. And so hopefully, it's (inaudible) the Company. So it's always hard to say. I tend to think that it's hard to really -- I think it would be misleading to say that we're built on long-term projects. We're really built on helping customers with not one week project, but short-term projects.

Avi Fischer - ***Harris Nesbitt - Analyst***

Got you. Thanks. I just have one more quick question. Do you have constant currency growth temp and perm for the quarter?

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

David and Rich, do we have that?

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

I don't know if we have it.

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

I’m sure we have it. We may not have it right here at our finger tips, but if you give Dave Kirby a call. By the time he gets back to his office, he'll have it, I'm sure.

David Kirby - ***Hudson Highland Group - Dir. IR***

We can do that now. Temp was up 14% and perm was up 9% year-over-year in a quarter, okay?

Avi Fischer - ***Harris Nesbitt - Analyst***

Alright. Thank you very much. And again, I want to echo Matt, thanks Rich for your help.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Thank you.

Operator

Once again, I would like to remind everyone, in order to ask a question, press "star, one" on your telephone keypad.

Your next question comes from Marc Marcon of RW Baird.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

We were wondering where you were, Marc.

Mark Marcon - ***RW Baird - Analyst***

I have been here all along. Congratulations on a great quarter.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Thank you.

Marc Marcon - ***RW Baird - Analyst***

I'm curious, you know, you mentioned obviously, that the macro environments changed. What would be an unreasonably low expectation for revenue growth for next year?

Jon Chait - Hudson Highland Group - Chairman & CEO

Well, I think what we're signaling is that our view of the world is that our outlook for next year is really dependent on the expansion of our margin rather than the growth of our revenues.

Mark Marcon - ***RW Baird - Analyst***

Right.

Jon Chait - Hudson Highland Group - Chairman & CEO

And we can focus our expansion of margin and drive that, which will drive our earnings independent of revenue growth. And at the moment, our attitude about revenue growth is -- I think you are the one that's forecasting 7%, right?

Marc Marcon - ***RW Baird - Analyst***

We were. Yes.

Jon Chait - Hudson Highland Group - President, Chairman & CEO

Yes. Our response about revenue growth or even in a low revenue growth environment, say 5 to 10%. So we can still achieve our EBITDA goals.

Mark Marcon - ***RW Baird - Analyst***

Okay. And would you still need it to be kind of in that 5 to 10% range to get to the EBITDA goals, in terms of generating the SG&A leverage that you would that -- in other words, are you depending on SG&A leverage in order to get there or are there some other things that even if you didn't have revenue growth, there is still some expenses that are coming out of this system that lead to EBITDA growth?

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

I'll take a shot at that. I think there is no question, there is EBITDA leverage that is a key element to where we end up in the range. But Jon and I have been religious about this since day one when we started setting these stakes in the ground about profitability is we can't let the economy solve our issues. This business was not structured properly; it wasn't driven for profitability. We have spent a lot of time in our leadership efforts to make sure we educate our people about profitability and where we need to get to, and why we need to get there.

And so our view, quite frankly, is if it's a 0% growth, we have to make the number -- we have to get there. We have to drive the business in that way. Now, clearly, if there was no growth, it's a lot tougher because the leverage really -- and but the reality is we don't think that's realistic. The direction of our business, the strategic direction that Jon has outlined, the execution we're seeing in our operating management, we believe we will grow faster than the economies in our operating regions.

It's just that right now, before we enter our planning cycle, keep in mind, we're putting somewhat of a stake in that says we realize that there are couple of our regions where we have significant scale of our overall business that are not strong growth economic regions. And the type of job we're seeing happen in Europe, for example, is representative of that. They are clearly bucking the trend of the economies in their countries. We've seen outstanding expense leverage in operating control out of Australia in what's been a strong growth environment, but it's a relatively contained economy. And so we have different issues that affect different regions and at the end of the day, by driving it from a profitability perspective, rather than just revenue growth for revenue growth sake, that's where we are getting it. Our people -- we've only increased our headcount 2% year-over-year. I mean, it's just a fantastic result of what our people have done to grow this business on basically, the same basis of operation that we had a year ago.

Mark Marcon - ***RW Baird - Analyst***

Great. And what would be some of the areas that you can still -- ex the SG&A leverage, what are some of the areas where you can actually -- where you still have some room to cut expenses on an absolute basis?

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

Well, I think, what -- the way we look at the world is -- and Rich really summarized it, Marc, is it's just using box car numbers. When we came into the company, we had about 1.2 billion of revenues and we were losing money.

Mark Marcon - ***RW Baird - Analyst***

Right.

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

So while there are not red dollars or green dollars, one of the things that both Rich and I preach all the time is, look, guys, remember that 1.2 billion? Well, we've got to make that 1.2 billion profitable at a rational level and whether the rational level of just the first 1.2 billion is 5% , 7% or 10%, we have to make that a profitable business. There's no reason why a business that produces 1.2 billion in revenues cannot be profitable.

Mark Marcon - ***RW Baird - Analyst***

Sure. Especially with your gross margins.

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

Right. Exactly, absolutely, and our mix of business with the perm mix of business, predominantly perm mix of business. So our team has done a fantastic job. It's not the two of us. The team has that taken that to heart. They have done a fantastic job. They have grounded out through the last 2 plus years. And we remain confident that they will continue to grind it out. And I think Rich put it very, very well. With a little economic growth, a little revenue growth, it makes things a lot easier to do. But I'm confident they'll find a way. We will continue to find the way to get our numbers even if there isn't.

Mark Marcon - ***RW Baird - Analyst***

And then, your performance in the U.K., given what we've been reading about the macro environment over there, was terrific. Can you give just a little more color in terms of some of the accounts that you let go and what sort of businesses -- what sort of business you ended up picking up and how that shifted?

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

Yes. In all of our markets, we have streams of business, which I'm sure you'll appreciate --

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Mark Marcon - ***RW Baird - Analyst***

Sure.

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

-- just every business and we -- so even when you look at -- take IT, even when you look at the IT practice group, within it, there's streams of businesses, streams of customers, streams of specific skills sets that we are supplying. One of the things that our team there, and you know, give them all the credit for this -- this is very much locally driven -- has become extremely religious -- relentless about focusing and breaking down the profitability of each line of their business. And that something that did not exist when we came to the company, and they have really gotten to grips with us in the last year. And we're seeing the results today of actions that were taken 3 and 6 months ago where they began to realize what parts of their business were generating strong EBITDA, and what parts of the business -- frankly, were not.

And so it's -- you've been in the business a while, Mark, so you've heard this from other people, a situation where there were some large contracts that were at relatively low margins and when you actually got all the numbers out, it was clear that they were either unprofitable or very marginally profitable. And over the course of the last 6 months, we've exited those contracts, let some of our competitors have them, who frankly have more scale, and who are set up better to do that kind of business. So they can do it and we can't. And then we focused our energy on contracts that have both higher margins and a better mix of business, so contracts that have more perm in them where we're excellent at permanent recruitment in Hudson around the world. And also we focused our efforts on growing our business in accounting and finance or other aspects of the IT business that simply have higher margins. The team there should get all the credit. The did a fantastic job. I mean, I think in my letter, I have some of the details. I think there are up -- 84% of EBITDA in the quarter. That's --

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Mark Marcon - ***RW Baird - Analyst***

Yes.

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

-- and the U.K. has a summer holiday phenomenon as well. Everybody wants to kick the French around, but all over the Northern Hemisphere, including the US, we all have summer holiday phenomenon.

Mark Marcon - ***RW Baird - Analyst***

In terms of streamlining out of some of those less profitable businesses and concentrating more on accounts where there are some true profits, how far along are you in that process? Are you still in the early stages there or --

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

Well, from my perspective, and I say this with a smile because, of course, I'm here to be the most aggressive, I would say we're in the middle.

Mark Marcon - ***RW Baird - Analyst***

Okay.

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

We still have room for improvement. We still have opportunity in front of us, not so much from the exit standpoint as much as the expand and build up standpoint, be better in the higher margin areas, become more specialized, be perceived as more of an expert in those higher margin lines, which will drive our business, and I think there is room for us to do better. I think we have a great team in the U.K., and I think they will do better.

Mark Marcon - ***RW Baird - Analyst***

Well, what's your --

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

Now, I really put the pressure on them.

Mark Marcon - ***RW Baird - Analyst***

Okay. What's your perception of the market reception to the Hudson brand at this point? Given its heritage, how strong would you say that is at this point?

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

We're stronger than we were 2 years ago. Frankly, when I look back at where we were 2 years ago, I'm amazed at how well our operating guys and gals have done. I mean, 2 years ago, we were starting off with a name that not only nobody knew, but you couldn't even say, "formerly known as" --

Mark Marcon - ***RW Baird - Analyst***

Right.

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

-- because nobody ever heard of TMP. I mean, I'm sorry, but in the real world of operations, nobody had ever heard of that name. It wasn't ever really drilled into the market. So I think we've come from is that we came from nowhere. Are we where we want to be? Absolutely not. You know, the brand is, I would say, still a new brand. We've done some work fairly recently on brand attributes and perceptions. And clearly, we're still a new brand. We're not as well known in the market as we'd like to be. I think that's an opportunity for us, because I think actually, when you are in a business that's reshaping itself, being in a position where we can now build the brand along the lines we want it to be is a lot better position than having to change a perception. So we're still building our perception. So again I look at it -- we still have a great opportunity in terms of building our brand. But we've come from absolutely position "Z."

Mark Marcon - ***RW Baird - Analyst***

Great. And in terms of thinking about the tax rate for next year, I mean should we still just assume full taxes in Australia and essentially very little in terms of taxes elsewhere?

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

That's exactly right. The taxes will be in Australia, Asia and pretty much everywhere else. Where there's significant dollars of operating income, we've got the ability to use tax loss carry-forwards against it.

Mark Marcon - ***RW Baird - Analyst***

Great. And then any --

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

Okay. Mark, your last question here, because we do -- we love to talk to you, Marc, but you can come in and talk to us.

Mark Marcon - ***RW Baird - Analyst***

Alright. I'll come back offline. Thanks a lot, and, Rich, thanks for all of your help --

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Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

Alright.

Mark Marcon - ***RW Baird - Analyst***

-- over this time.

Rich Pehlke - ***Hudson Highland Group - EVP & CFO***

You're welcome, Mark. Thank you.

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

Take care. Bye.

Operator

At this time, there are no further questions.

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

I figured that.

Operator

Mr. Kirby, are there any closing remarks?

David Kirby - ***Hudson Highland Group - Dir. IR***

Yes, there are, operator. Thank you. Thank you all for joining the Hudson Highland Group's Third Quarter Conference Call. If there are any further questions, please feel free to contract Rich Pehlke or myself, David Kirby, at any time. You can reach Rich at 212-351-7285, and you can reach me at 212-351-7216.

The call today has been recorded and will be available after 11:30 AM Eastern by calling 800-642-1687, followed by the pass-code 1462858. For callers outside the US, please dial 1-706-645-9291, followed by the same pass-code. Those archived calls 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, and have a great day.

Operator

This concludes the Hudson Highland Group conference call. You may now disconnect.