

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
**For the quarterly period ended September 28, 2003**  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-6081

**COMFORCE Corporation**  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

36-2262248  
(IRS Employer Identification No.)

415 Crossways Park Drive, P.O. Box 9006, Woodbury, New York 11797  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (516) 437-3300

Not Applicable  
Former name, former address and former fiscal year, if changed since last report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class  
Common stock, \$.01 par value

Outstanding at November 11, 2003  
16,659,394 shares

# COMFORCE Corporation

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## PART I - FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

#### COMFORCE CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (in thousands, except share and per share amounts)

	September 28, 2003 (unaudited)	December 29, 2002
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,915	\$ 6,378
Accounts receivable, net	51,891	45,244
Funding and service fees receivable, net	22,175	28,365
Prepaid expenses and other current assets	5,598	6,391
Deferred income taxes, net	2,741	1,858
Total current assets	87,320	88,236
Property and equipment, net	9,196	11,612
Intangible assets, net	148	198
Goodwill, net	32,242	60,242
Deferred financing costs, net	2,432	2,576
Total assets	\$ 131,338	\$ 162,864
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 1,614	\$ 2,957
Accrued expenses	44,101	37,893
Total current liabilities	45,715	40,850
Long-term debt	124,135	142,779
Deferred income taxes, net	161	161
Other liabilities	144	315
Total liabilities	170,155	184,105
Commitments and contingencies		
Stockholders' deficit:		
Common stock, \$.01 par value; 100,000,000 shares authorized; 16,659,379 shares and 16,659,360 shares issued and outstanding at September 28, 2003 and December 29, 2002, respectively	167	167
Convertible preferred stock	4,817	--
Additional paid-in capital	50,501	49,588
Accumulated other comprehensive income (loss)	49	(47)
Accumulated deficit	(94,351)	(70,949)
Total stockholders' deficit	(38,817)	(21,241)
Total liabilities and stockholders' deficit	\$ 131,338	\$ 162,864

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands except per share amounts)  
(unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 28, 2003	Sept. 29, 2002	Sept. 28, 2003	Sept. 29, 2002
Revenue:				
Net sales of service	\$ 96,343	\$ 97,906	\$ 276,027	\$ 290,486
Costs and expenses:				
Cost of services	80,437	80,361	229,218	237,758
Selling, general and administrative expenses	13,334	13,599	37,209	41,279
Goodwill impairment	28,000	--	28,000	--
Depreciation and amortization	1,090	1,004	3,207	2,985
Total costs and expenses	122,861	94,964	297,634	282,022
Operating (loss) income	(26,518)	2,942	(21,607)	8,464
Other income (expense):				
Interest expense	(3,267)	(4,131)	(10,678)	(12,171)
Write-off of deferred financing costs	--	--	(431)	--
Gain on debt extinguishment	--	--	8,774	--
Other income, net	(26)	55	619	218
	(3,293)	(4,076)	(1,716)	(11,953)
Loss before tax and a cumulative effect of a change in accounting principle	(29,811)	(1,134)	(23,323)	(3,489)
Provision (benefit) for income taxes	(3,721)	(340)	79	(769)
Loss before a cumulative effect of a change in accounting principle	(26,090)	(794)	(23,402)	(2,720)
Cumulative effect of a change in accounting principle -- goodwill impairment, net of tax benefit	--	--	--	(52,800)
Net loss	\$ (26,090)	\$ (794)	\$ (23,402)	\$ (55,520)
Dividends on preferred stock	381	--	546	--
Loss attributable to common stockholders	\$ (26,471)	\$ (794)	\$ (23,948)	\$ (55,520)
Basic and diluted loss per common share:				
Loss before a cumulative effect of a change in accounting principle	\$ (1.59)	\$ (0.05)	\$ (1.44)	\$ (0.16)
Cumulative effect of a change in accounting principle - goodwill impairment	--	--	--	(3.17)
Net loss	\$ (1.59)	\$ (0.05)	\$ (1.44)	\$ (3.33)
Weighted average common shares outstanding, basic and diluted	16,659	16,659	16,659	16,659

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)  
(unaudited)

	Nine Months Ended	
	September 28, 2003	September 29, 2002
Cash flows from operating activities:		
Net loss	\$ (23,402)	\$ (55,520)
Adjustments to reconcile net loss		
to net cash provided by operating activities:		
Depreciation and amortization	3,207	2,985
Amortization of deferred financing fees	527	682
Issuance of notes in lieu of interest	351	1,104
Gain on repurchase of Senior Notes	(983)	--
Gain on repurchase of PIK Debentures	(7,791)	--
Write-off of deferred financing fees	431	--
Write-off of goodwill, net of tax	--	52,800
Goodwill impairment	28,000	--
Gain on sale of fixed assets	--	(156)
Deferred income tax expense	(883)	--
Changes in assets and liabilities, net of effects of acquisitions of businesses:		
Accounts receivable and funding service fees receivable	(361)	4,652
Prepaid expenses and other current assets	(328)	932
Accounts payable and accrued expenses	4,675	4,783
Decrease in income tax expense	1,121	810
Net cash provided by operating activities	4,564	13,072
Cash flows from investing activities:		
Purchases of property and equipment	(673)	(2,504)
Cash proceeds from sale of fixed assets	--	434
Payments of contingent consideration	--	(323)
Net cash used in investing activities	(673)	(2,393)
Cash flows from financing activities:		
Net repayments under capital lease obligations	(204)	(135)
Net repayments under line of credit agreements	(3,000)	(9,917)
Repurchase of Senior Notes and PIK Debentures	(1,042)	--
Debt financing costs	(1,108)	(221)
Net cash used in financing activities	(5,354)	(10,273)
Net (decrease) increase in cash and cash equivalents	(1,463)	406
Cash and cash equivalents at beginning of period	6,378	4,067
Cash and cash equivalents at end of period	\$ 4,915	\$ 4,473
Supplemental disclosures:		
Cash paid for:		
Interest	\$ 6,419	\$ 7,001
Income taxes	329	362
Supplemental schedule of significant non-cash financing activities:		
Issuance of 2003A Convertible Preferred Stock in exchange for PIK Debentures	\$ 4,304	--
Issuance of 2003B Convertible Preferred Stock in exchange for Subordinated Convertible Notes	513	--
Exchange of PIK Debentures for the Issuance of 2003A Convertible Preferred Stock	12,335	--
Exchange of 8% Subordinated Convertible Notes for the issuance of 2003B Convertible Preferred Stock	2,052	--
Contribution of capital as a result of the exchange of 8% Subordinated Convertible Notes	913	--

The accompanying notes are an integral part of the unaudited consolidated financial statements.

COMFORCE CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**1. GENERAL**

The accompanying unaudited interim consolidated financial statements of COMFORCE Corporation (“COMFORCE”) and its subsidiaries, including COMFORCE Operating, Inc. (“COI”) (collectively, the “Company”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. Although management believes that the disclosures made are adequate to ensure that the information presented is not misleading, these financial statements should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 29, 2002. The results for the three and nine months ended September 28, 2003 are not necessarily indicative of the results of operations for the entire year.

**2. STOCK COMPENSATION PLANS**

During December 2002, the FASB issued SFAS 148 which provides for alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

The Company applies APB Opinion 25 and related interpretations in accounting for stock options; accordingly, no compensation cost has been recognized for any employees, officers or directors. Had compensation cost been determined based upon the fair value of the stock options at grant date consistent with the method in SFAS 123, the Company’s net loss and loss per share would have been increased to the pro forma amounts indicated below:

	Three months ended		Nine months ended	
	Sept. 28, 2003	Sept. 29, 2002	Sept. 28, 2003	Sept. 29, 2002
	(in thousands, except per share amounts)			
Net loss as reported	\$ (26,090)	\$ (794)	\$ (23,402)	\$ (55,520)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	7	35	23	103
Pro forma loss	\$ (26,097)	\$ (829)	\$ (23,425)	\$ (55,623)
Loss per share:				
Basic and diluted - as reported	\$ (1.59)	\$ (0.05)	\$ (1.44)	\$ (3.33)
Basic and diluted-pro forma	(1.59)	(0.05)	(1.44)	(3.34)

### 3. DEBT

Notes payable and long-term debt at September 28, 2003 and December 29, 2002 consisted of (in thousands):

	September 28, 2003	December 29, 2002
12% Senior Notes, due 2007	\$ 85,000	\$ 87,000
15% Senior Secured PIK Debentures, due 2009	--	11,995
8% Subordinated Convertible Notes due 2009	7,135	8,784
Revolving line of credit, due August 31, 2004, with interest payable monthly at LIBOR plus 3.00% with a weighted average rate of 4.64% at December 29, 2002	--	35,000
Revolving line of credit, due June 24, 2007, with interest payable monthly at LIBOR plus 2.75% with a weighted average rate of 3.87% at September 28, 2003	32,000	--
Total long-term debt	<u>\$ 124,135</u>	<u>\$ 142,779</u>

In June 2003, COMFORCE, COI and various of their operating subsidiaries entered into a Revolving Credit and Security Agreement (the "PNC Credit Facility") with PNC Bank, National Association, as a lender and administrative agent ("PNC") and other financial institutions participating as lenders to provide for a \$75.0 million revolving credit facility with available borrowings to be based upon a specified percentage of the Company's eligible accounts receivable. At closing, the Company borrowed \$32.7 million and repaid the Company's then existing revolving credit facility agent by Whitehall Business Credit Corporation (the "Whitehall Credit Facility"), which was thereupon terminated. The Whitehall Credit Facility, which the Company entered into in December 2000, as subsequently amended, provided for borrowings of up to \$85.0 million. The Company wrote-off approximately \$431,000 of deferred financing costs in the second quarter of 2003 for the early retirement of the Whitehall Credit Facility.

Borrowings under the PNC Credit Facility bear interest, at the Company's option, at a per annum rate equal to either (1) the greater of the base commercial lending rate of PNC as announced from time to time or the federal funds rate plus 0.5%, or (2) LIBOR plus a margin ranging from 2.5% if the Company's fixed charged coverage ratio is greater than 1.30:1 to 3.0% if this ratio is 1.05:1 or less (with the initial margin fixed at 2.75% until September 1, 2003). The obligations evidenced by the PNC Credit Facility are collateralized by a pledge of the capital stock of certain key operating subsidiaries of the Company and by security interests in substantially all of the assets of the Company. The agreements evidencing the PNC Credit Facility contain various financial and other covenants and conditions, including, but not limited to, limitations on paying dividends, engaging in affiliate transactions, making acquisitions and incurring additional indebtedness. The scheduled maturity date of the PNC Credit Facility is June 24, 2007. The PNC Credit Facility affords the Company greater borrowing flexibility and has a maturity date close to three years beyond the maturity date of the Whitehall Credit Facility. As of September 28, 2003, the Company had remaining availability based upon then outstanding eligible accounts receivable of \$24.7 million based upon the borrowing base formula.

In February 2003, the Company issued \$6.1 million face amount of its new Series 2003A Convertible Preferred Stock ("Series 2003A Preferred Stock") having a fair market value of \$4.3 million in exchange for \$12.3 million of its outstanding 15% Senior Secured PIK Debentures, due 2009 ("PIK Debentures"), including accrued interest, in a transaction with a related party, and repurchased additional PIK Debentures (\$59,000 including interest) from unrelated parties for a cash payment of \$21,000. The remaining PIK Debentures were subsequently redeemed in May 2003.

In June 2003, the Company repurchased from unrelated parties \$2.0 million principal amount of its 12% Senior Notes due 2007 ("Senior Notes") for \$980,000, resulting in a gain on debt extinguishment of \$983,000, which includes the reduction of approximately \$37,000 of deferred financing costs.

Effective as of September 26, 2003, the Company issued 513 shares of its Series 2003B Convertible Preferred Stock ("Series 2003B Preferred Stock") having an aggregate face amount and fair market value of \$513,000 in exchange for \$2.0 million principal amount of the Company's 8.0% Subordinated Convertible Notes due 2009 (the "Convertible Notes"), plus accrued interest, in a transaction with a related party, which is a partnership in which John Fanning, the Company's chairman and chief executive officer, holds the principal economic interest. As a result of this transaction, the Company recorded a contribution to capital of \$913,000, net of taxes, in lieu of recognizing a gain on the extinguishment of debt. See note 7.

The debt service costs associated with the Convertible Notes may be satisfied through issuance of new Convertible Notes through December 1, 2003. Beginning with the interest payment due June 1, 2004, COMFORCE will be required to pay interest on the Convertible Notes in cash. Its ability to do so is expected to be dependent on its availability of funds for this purpose, whether through borrowings by COI under its new revolving credit facility agented by PNC Bank, National Association, funds from COI's operations or otherwise, and on COI's ability to upstream funds in accordance with the restricted payments test under the indenture for the Senior Notes. COMFORCE's ability to repay Convertible Notes at their maturity on December 2, 2009, or on any earlier required repayment or repurchase dates, will also be dependent on any restrictions under its loan agreements as then in effect and availability of funds.

Under the indenture governing the Senior Notes, COI is subject to restrictions in upstreaming funds to its parent COMFORCE. The Company does not currently have sufficient availability under the indenture to make a cash payment of semi-annual interest under the Convertible Notes. Management believes that \$2.0 million annually (if COI has funds available for this purpose) will be sufficient to pay COMFORCE's annual public company expenses for the foreseeable future. Principally as a result of losses incurred by COI in fiscal 2002 and nine months ended September 28, 2003 and prior distributions made by COI to COMFORCE, COI can make no distributions to COMFORCE based upon the cumulative net income provisions of the indenture. It is anticipated that COI must generate net income of approximately \$5.5 million before it will be able to upstream funds to COMFORCE under the restrictive payments test of the indenture. In calculating net income for this purpose, under the terms of the indenture, the Company must apply generally accepted accounting principles as in effect at the time the indenture was entered into in 1997. The holder of the Convertible Notes, which, as described above and in note 7, is a partnership in which the Company's chairman and chief executive officer holds the principal economic interest, has advised that it will agree to extend the payment-in-kind terms or make other mutually acceptable arrangements if the Company does not have adequate availability under the indenture to upstream funds to make cash payments of interest on the Convertible Notes commencing June 1, 2004. The Company expects to pay appropriate consideration to the holder for agreeing to this accommodation as may be negotiated by the parties in consultation with an independent financial advisor.

#### **4. FISCAL YEAR**

In March 2001, the Company's Board of Directors adopted a resolution to change the Company's fiscal year, which was previously a calendar year. Beginning in 2001, the fiscal year consists of the 52 or 53 weeks ending on the last Sunday in December. Accordingly, the Company's current fiscal year will end on Sunday, December 28, 2003.

#### **5. LOSS PER SHARE**

Basic loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during each period. Diluted loss attributable to common stockholders per share is computed assuming the conversion of stock options and warrants with a market value greater than the exercise price, as well the conversion of the Convertible Note and Preferred Stock into shares of common stock to the extent such conversion assumption is dilutive. The following represents a reconciliation of the numerators and denominators for basic and diluted loss per share computation (in thousands):

	Three Months Ended		Nine Months Ended	
	Sept. 28, 2003	Sept. 29, 2002	Sept. 28, 2003	Sept. 29, 2002
Numerator:				
Loss before a cumulative effect of a change in accounting principle	\$ (26,090)	\$ (794)	\$ (23,402)	\$ (2,720)
Cumulative effect of a change in accounting principle-goodwill impairment, net of tax benefit	--	--	--	(52,800)
Net Loss	\$ (26,090)	\$ (794)	\$ (23,402)	\$ (55,520)
Dividends on preferred stock	381	--	546	--
Loss available to common stockholders	<u>\$ (26,471)</u>	<u>\$ (794)</u>	<u>\$ (23,948)</u>	<u>\$ (55,520)</u>
Denominator:				
Weighted average common shares outstanding, basic and diluted	16,659	16,659	16,659	16,659

Outstanding options and warrants to purchase shares of common stock, representing approximately 4.0 million shares of common stock, were not included in the computations of diluted net loss per share for the three and nine months ended September 28, 2003 because their effect would be anti-dilutive. In addition, 4.2 million shares issuable upon conversion of the Convertible Notes and 7.1 million shares issuable upon conversion of preferred stock were excluded from the September 28, 2003 calculation as their effect would have been anti-dilutive.

## 6. INDUSTRY SEGMENT INFORMATION

COMFORCE has determined that its reportable segments can be distinguished principally by the types of services offered to the Company's clients.

The Company reports its results through three operating segments -- Staff Augmentation, Human Capital Management Services and Financial Outsourcing Services. The Staff Augmentation segment provides information technology (IT), technical, telecom, healthcare support and other staffing services. The Human Capital Management Services segment provides contingent workforce management services. The Financial Outsourcing Services segment provides funding and back office support services to independent consulting and staffing companies.

The accounting policies of the segments are the same as those described in note 2 to the consolidated financial statements of the Company included in the Company's Annual Report on Form 10-K for the year ended December 29, 2002. COMFORCE evaluates the performance of its segments and allocates resources to them based on operating contribution, which represents segment revenues less direct costs of operations, excluding the allocation of corporate general and administrative expenses. Assets of the operating segments reflect primarily net accounts receivable and goodwill associated with segment activities; all other assets are included as corporate assets. The Company does not account for expenditures for long-lived assets on a segment basis.

The table below presents information on the revenues and operating contribution for each segment for the three and nine months ended September 28, 2003 and September 29, 2002, and items which reconcile segment operating contribution to COMFORCE's reported pre-tax loss before a cumulative effect of a change in accounting principle (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2003	September 29, 2002	September 28, 2003	September 29, 2002
Net sales of services:				
Staff Augmentation Human Capital Management Services	\$ 47,948	\$ 52,902	\$ 136,544	\$ 160,716
Financial Outsourcing Services	46,667	42,898	134,659	123,006
	1,728	2,106	4,824	6,764
	<u>\$ 96,343</u>	<u>\$ 97,906</u>	<u>\$ 276,027</u>	<u>\$ 290,486</u>
Operating contribution:				
Staff Augmentation(1) Human Capital Management Services	\$ (23,965)	\$ 4,897	\$ (17,224)	\$ 14,249
Financial Outsourcing Services (2)	1,277	1,089	5,309	3,996
	1,178	1,510	4,808	4,290
	<u>(21,510)</u>	<u>7,496</u>	<u>(7,107)</u>	<u>22,535</u>
Consolidated expenses (income):				
Corporate general and administrative expenses	3,918	3,550	11,293	11,086
Depreciation and amortization	1,090	1,004	3,207	2,985
Interest and other, net	3,293	4,076	10,059	11,953
Write-off of deferred financing costs	--	--	431	--
Gain on debt extinguishment	--	--	(8,774)	--
	<u>8,301</u>	<u>8,630</u>	<u>16,216</u>	<u>26,024</u>
Loss before tax and a cumulative effect of a change in accounting principle	<u>\$ (29,811)</u>	<u>\$ (1,134)</u>	<u>\$ (23,323)</u>	<u>\$ (3,489)</u>
	<b>At September 28, 2003</b>	<b>December 29, 2002</b>		
Total assets:				
Staff Augmentation Human Capital Management Services	\$ 50,234	\$ 73,382		
Financial Outsourcing Services	33,899	32,104		
Corporate	22,175	28,365		
	25,030	29,013		
	<u>\$ 131,338</u>	<u>\$ 162,864</u>		

(1) The Company recorded a goodwill impairment charge of \$28.0 million during the third quarter of 2003 as a charge against operating income in accordance with the provisions of SFAS 142. See note 11.

(2) Included in the nine months ended September 28, 2003 is a \$1.6 million insurance recovery recorded in the first quarter of 2003 that related to funding and services fees receivable of \$2.4 million which were written off in the fourth quarter of 2001.

## **7. PREFERRED STOCK**

In February 2003, the Company issued \$6.1 million face amount (6,100 shares) of its new Series 2003A Preferred Stock having a fair market value of \$4.3 million in exchange for \$12.3 million of its outstanding PIK Debentures (including accrued interest) from the Fanning CPD Assets, LP, a limited partnership in which John C. Fanning, the Company's chairman and chief executive officer, holds the principal economic interest (the "Fanning Partnership"). Rosemary Maniscalco, a director of the Company, is the general partner of the Fanning Partnership, but has no pecuniary interest therein. The Company obtained the opinion of an independent investment banking firm that the terms of the exchange transaction with the Fanning Partnership were fair to the Company from a financial point of view, and the Company's independent directors approved the terms of the transaction. The consideration paid to the Fanning Partnership in February 2003 for the principal amount of the PIK Debentures exchanged in this transaction approximated in value the consideration that the Fanning Partnership had previously been paid to the unrelated third party sellers of the PIK Debentures. The Company's offer to exchange PIK Debentures for Series 2003A Preferred Stock was extended to all holders of the PIK Debentures that remained outstanding.

In September 2003, the Company issued shares of its Series 2003B Preferred Stock having a face amount and fair market value of \$513,000 (513 shares) in exchange for \$2.0 million aggregate amount of the Company's 8.0% Subordinated Convertible Notes due 2009 (the "Convertible Notes"), plus accrued interest, in a transaction with the Fanning Partnership. The Company obtained the opinion of an independent investment banking firm that the terms of the exchange transaction with the Fanning Partnership were fair to the Company from a financial point of view, and the Company's directors approved the terms of the transaction. The consideration paid to the Fanning Partnership in September 2003 for the principal amount of the Convertible Notes exchanged in this transaction was substantially less than the consideration paid by the Fanning Partnership for the securities it had previously exchanged for the Convertible Notes. As a result, the Company has treated this transaction as a contribution to capital and has recorded an additional \$913,000 to additional paid-in capital. In addition, the conversion price of \$0.54 per share for the Series 2003B Preferred Stock, as discussed below, represents the average closing price of the common stock for the 15 trading days immediately preceding the date of the effective date of the transaction (September 26, 2003), it was lower than the \$0.82 per share closing price as of the effective date. As a result of this beneficial conversion feature, the Company recorded a preferred stock dividend of \$266,000 in the third quarter of fiscal 2003.

The rights and preferences of the Series 2003A and Series 2003B Preferred Stock are substantially identical except that conversion price is \$1.05 for the Series 2003A Preferred Stock and \$0.54 for the Series 2003B Preferred Stock. The conversion price is the price at which a holder of shares of Series 2003A or 2003B Preferred Stock may convert such shares into common stock (or, in certain circumstances, into a participating preferred stock which in turn will be convertible into common stock at the same effective rate).

Each share of Series 2003A and 2003B Preferred Stock has a face amount of \$1,000, and bears annual cumulative dividends of \$75 per share (7.5% per annum). As of September 28, 2003, there were cumulative unpaid dividends of \$280,000. Upon liquidation, the holders of the Series 2003A and 2003B Preferred Stock will be entitled to a liquidation preference of \$1,000 per share plus the amount of accumulated, unpaid dividends before any distributions shall be made to the holders of common stock or any other junior series or class of stock of the Company. Unless the holders of two-thirds of the shares of Series 2003A and 2003B Preferred Stock outstanding shall have otherwise consented, no series or class of preferred stock having rights or preferences that are not junior to the Series 2003A and 2003B Preferred Stock shall be issued by the Company.

The Company can only pay dividends on the Series 2003A and 2003B Preferred Stock if (i) dividends can legally be paid in accordance with Delaware law, (ii) the Company's board of directors, in its discretion upon the exercise of its fiduciary duties, declares that a dividend be paid, (iii) payment of the dividend is permitted under the terms of the PNC Credit Facility, and (iv) the Company has sufficient funds to upstream in accordance with the restricted payments tests under the indenture governing the Senior Notes.

In the event that the conversion of Series 2003A and 2003B Preferred Stock into common stock of COMFORCE would result in either (i) the occurrence of a “change of control” as defined in the indenture governing COI’s Senior Notes, or (ii) require stockholder approval in accordance with the rules and regulations of the Securities and Exchange Commission or the American Stock Exchange (or any other exchange or quotation system on which the Company’s shares are then listed), then the Series 2003A and 2003B Preferred Stock held by such holder shall not be convertible into common stock, but rather shall be convertible into shares of non-voting participating preferred stock having a liquidation preference of \$0.01 per share (but no other preferences) to be created by the Company. The participating preferred stock will in turn be convertible into the Company’s common stock (on the same basis as if the conversion to common stock from Series 2003A and 2003B Preferred Stock had occurred directly) if the conversion will not result in a “change of control” as defined in the indenture governing the Senior Notes or require stockholder approval in accordance with the rules and regulations of the Securities and Exchange Commission or the American Stock Exchange (or any other exchange or quotation system on which the Company’s shares are then listed). At the request of the holders of a majority of the outstanding participating preferred stock, the Company will seek stockholder approval for its conversion into common stock.

## **8. NEW ACCOUNTING STANDARDS**

In December 2002, the Financial Accounting Standards Board (“FASB”) issued Statement No. 148, *Accounting for Stock-Based Compensation--Transition and Disclosure* (“SFAS 148”). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by Statement No. 123, *Accounting for Stock-Based Compensation* (“SFAS 123”). Additionally, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transitional requirements of SFAS 148 are effective for all financial statements for fiscal years ending after December 15, 2002. The Company adopted the disclosure portion of this statement beginning for the fiscal quarter ended March 30, 2003. The application of the disclosure portion of this standard did not have any impact on the Company’s consolidated financial position or results of operations. The FASB has indicated that it will require stock-based employee compensation to be recorded as a charge to earnings in the future. The Company will continue to monitor the FASB’s progress on the issuance of this standard as well as to evaluate its position with respect to current guidance.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (“SFAS 150”). This accounting standard establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. It requires that certain financial instruments that were previously classified as equity now be classified as a liability. This accounting standard is effective for financial instruments entered into or modified after May 31, 2003, and otherwise at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement did not have a material impact on the consolidated financial statements.

## **9. RECLASSIFICATIONS**

Certain reclassifications have been made to conform prior period amounts to the current period presentation.

## 10. COMPREHENSIVE INCOME

The components of comprehensive income are as follows (in thousands):

	Three months ended		Nine months ended	
	Sept. 28, 2003	Sept. 29, 2002	Sept. 28, 2003	Sept. 29, 2002
Net loss, as reported	\$ (26,090)	\$ (794)	\$ (23,402)	\$ (55,520)
Foreign currency translation adjustment	—	(184)	96	31
Total comprehensive loss	<u>\$ (26,090)</u>	<u>\$ (978)</u>	<u>\$ (23,306)</u>	<u>\$ (55,489)</u>

## 11. GOODWILL IMPAIRMENT

The Company tested goodwill for impairment in accordance with the provisions of SFAS 142 as of the end of the third quarter of fiscal year 2003. In connection with this goodwill test, the Company engaged an independent firm to assist management in the determination of the fair values of its reporting units (as defined by SFAS 142). In its determination of the fair values, the firm engaged by the Company primarily utilized a discounted cash flow analysis as well as various other valuation approaches, including (a) recent values paid by investors and purchasers of companies in businesses similar to that of the Company, (b) capitalization multiples of companies with investment characteristics resembling those of the reporting units, (c) the enterprise value of the Company, and (d) asset and liability structure.

Significant assumptions used in this analysis include (i) expected future revenue growth rates, operating unit profit margins, and working capital levels, (ii) a discount rate, and (iii) a terminal value multiple. The revenue growth rates, working capital levels and operating unit profit margins are based on management's expectation of future results. As previously discussed, the Company's operating results, including those of its more specialized operations, have been negatively impacted by general economic conditions. Based on management's assessment of the circumstances and considering the firm's findings, the Company recognized an impairment loss of \$28.0 million due to the Company's inability to meet previous growth expectations. These impairment losses relate primarily to the goodwill attributable to staffing companies acquired by the Company in 1996 through 1998, during which time staffing companies were customarily valued using higher multiples, and these companies had significantly higher earnings.

If management's expectations of future operating results change, or if there are changes to other assumptions, the estimate of the fair value of the Company's reporting units could change significantly. Such a change could result in additional goodwill impairment charges in future periods, which could have a significant impact on the Company's consolidated financial statements.

The changes in the carrying amount of goodwill for the nine months ended September 28, 2003 is as follows (in thousands):

	Staff Augmentation	Human Capital Management	Financial Outsourcing	Total
Balance as of December 29, 2002	\$ 51,042	\$ 9,200	--	\$ 60,242
Impairment losses	(28,000)	--	--	(28,000)
Balance as of September 28, 2003	<u>\$ 23,042</u>	<u>\$ 9,200</u>	<u>--</u>	<u>\$ 32,242</u>

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The discussion set forth below supplements the information found in the unaudited consolidated financial statements and related notes of COMFORCE Corporation ("COMFORCE") and its wholly-owned subsidiaries, including COMFORCE Operating, Inc. ("COI") (collectively, the "Company").

### **Overview**

Staffing personnel placed by the Company are employees of the Company. The Company is responsible for employee related expenses for its employees, including workers compensation, unemployment compensation insurance, Medicare and Social Security taxes and general payroll expenses. The Company offers health, dental, 401(k), disability and life insurance to its eligible billable employees. Staffing and consulting companies, including the Company, typically pay their billable employees for their services before receiving payment from their customers, often resulting in significant outstanding receivables. To the extent the Company grows, these receivables will increase and there will be greater requirements for borrowing availability under its credit facility to fund current operations.

The Company reports its results through three operating segments -- Staff Augmentation, Human Capital Management Services and Financial Outsourcing Services. The Staff Augmentation segment provides healthcare support, information technology (IT), telecom, technical and other staffing services. The Human Capital Management Services segment provides consulting services for managing the contingent workforce. The Financial Outsourcing Services segment provides payroll, funding and back office support services to independent consulting and staffing companies.

### **Replacement of Credit Facility**

On June 25, 2003, COMFORCE, COI and various of their operating subsidiaries entered into the PNC Credit Facility with PNC, as a lender and administrative agent, and other financial institutions participating as lenders to provide for a \$75.0 million revolving credit facility with available borrowings to be based upon a specified percentage of the Company's eligible accounts receivable. At closing, the Company borrowed \$32.7 million and repaid the Whitehall Credit Facility, which was thereupon terminated. The Whitehall Credit Facility, which the Company entered into in December 2000, as subsequently amended, provided for borrowings of up to \$85.0 million. The Company incurred a write-off of deferred financing costs of \$431,000 in the second quarter of 2003 related to the early retirement of the Whitehall Credit Facility.

Borrowings under the PNC Credit Facility bear interest, at the Company's option, at a per annum rate equal to either (1) the greater of the base commercial lending rate of PNC as announced from time to time or the federal funds rate plus 0.5%, or (2) LIBOR plus a margin ranging from 2.5% if the Company's fixed charged coverage ratio is greater than 1.30:1 to 3.0% if this ratio is 1.05:1 or less (with the initial margin fixed at 2.75% until September 1, 2003). The obligations evidenced by the PNC Credit Facility are collateralized by a pledge of the capital stock of certain key operating subsidiaries of the Company and by security interests in substantially all of the assets of the Company. The agreements evidencing the PNC Credit Facility contain various financial and other covenants and conditions, including, but not limited to, limitations on paying dividends, engaging in affiliate transactions, making acquisitions and incurring additional indebtedness. The scheduled maturity date of the PNC Credit Facility is June 24, 2007. The PNC Credit Facility affords the Company greater borrowing flexibility and has a maturity date close to three years beyond the maturity date of the Whitehall Credit Facility.

### **Goodwill Impairment**

The Company tested goodwill for impairment in accordance with the provisions of SFAS 142 as of the end of the third quarter of fiscal year 2003. In connection with this goodwill test, the Company engaged an independent firm to assist management in the determination of the fair values of its reporting units (as defined by SFAS 142). In its determination of the fair values, the firm engaged by the Company primarily utilized a discounted cash flow analysis as well as various other valuation approaches, including (a) recent values paid by investors and purchasers of companies in businesses similar to that of the Company, (b) capitalization multiples of companies with investment

characteristics resembling those of the reporting units, (c) the enterprise value of the Company, and (d) asset and liability structure.

Significant assumptions used in this analysis include (i) expected future revenue growth rates, operating unit profit margins, and working capital levels, (ii) a discount rate, and (iii) a terminal value multiple. The revenue growth rates, working capital levels and operating unit profit margins are based on management's expectation of future results. As previously discussed, the Company's operating results, including those of its more specialized operations, have been negatively impacted by general economic conditions. Based on management's assessment of the circumstances and considering the firm's findings, the Company recognized an impairment loss of \$28.0 million due to the Company's inability to meet previous growth expectations. These impairment losses relate primarily to the goodwill attributable to staffing companies acquired by the Company in 1996 through 1998, during which time staffing companies were customarily valued using higher multiples, and these companies had significantly higher earnings.

If management's expectations of future operating results change, or if there are changes to other assumptions, the estimate of the fair value of the Company's reporting units could change significantly. Such a change could result in additional goodwill impairment charges in future periods, which could have a significant impact on the Company's consolidated financial statements.

### **Critical Accounting Policies**

As disclosed in the annual report on Form 10-K for the fiscal year ended December 29, 2002, the discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements. These judgments can be subjective and complex, and consequently actual results could differ from those estimates. Our most critical accounting policies relate to allowance for doubtful accounts; reserves for workers' compensation; goodwill impairment; and income taxes. Since December 29, 2002, there have been no changes in our critical accounting policies and no other significant changes to the methods used in the assumptions and estimates related to them.

### **Results of Operations**

#### ***Three Months Ended September 28, 2003 Compared to Three Months Ended September 29, 2002***

Net sales of services for the three month period ended September 28, 2003 were \$96.3 million, a decrease of 1.6 % from net sales of services for the three month period ended September 29, 2002 of \$97.9 million. The Company experienced a decrease in net sales of services in Staff Augmentation and Financial Outsourcing Services segments, partially offset by an increase in the Human Capital Management Services segment. Net sales of services in the Human Capital Management Services segment increased by \$3.8 million or 8.8%, principally due to an increase in its client base. In the Staff Augmentation segment, the decrease of \$5.0 million (9.4%) is principally attributable to reduced sales to IT and telecom customers, as a result of the continuing effects of the soft economy, partially offset by increased sales to technical services customers. Also, principally as a result of the current economic conditions and a reduced client base, net sales of services were lower by \$378,000 (17.9%) in the Financial Outsourcing Services segment.

Cost of services for the three month period ended September 28, 2003 was 83.5% of net sales of services as compared to cost of services of 82.1% for the three month period ended September 29, 2002. The cost of services as a percentage of net sales for the three month period ended September 28, 2003 increased from the comparable period in 2002 principally as a result of a decrease in permanent placement fees, a decrease in Financial Outsourcing Services revenues, increased competitive pressures impacting fees and higher growth in Human Capital Management Services (which have a higher cost of services as a percentage of net sales of services).

Selling, general and administrative expenses as a percentage of net sales of services were 13.8% for the three month period ended September 28, 2003, compared to 13.9% for the three month period ended September 29,

2002. Management continued to undertake initiatives to reduce selling, general and administrative costs by renegotiating existing vendor contracts, reducing the size of or closing marginal offices, reducing back office support staff and re-evaluating incentive compensation plans, and has reduced costs as sales decreased. These costs were further reduced by lower commissions as a result of the decrease of sales discussed above.

Operating loss for the three month period ended September 28, 2003 was \$26.5 million as compared to operating income of \$2.9 million for the three month period ended September 29, 2002. The decrease in operating income for the three month period ended September 28, 2003 is principally attributable to the Company's third quarter \$28.0 million write-off related to the impairment of goodwill discussed above and a decrease in sales and gross margins in Staff Augmentation and Financial Outsourcing Services segments, offset by a decrease in selling, general and administrative expenses discussed above.

The Company's interest expense for the three month periods ended September 28, 2003 and September 29, 2002 were principally attributable to interest recorded on the Company's bank credit facilities, the Convertible Notes and the Senior Notes. The interest expense was lower for the three month period ended September 28, 2003 as compared to the three month period ended September 29, 2002 principally due to lower market interest rates and lower borrowing levels under the PNC Credit Facility (as compared to under the Whitehall Credit Facility, which was in place in 2002) as well as the retirement of PIK Debentures in the first quarter of 2003. See "Replacement of Credit Facility" and "Financial Condition, Liquidity and Capital Resources" in this Item 2.

The income tax benefit for the three month period ended September 28, 2003 was \$3.7 million on a loss before tax of \$29.8 million. The income tax benefit for the three month period ended September 29, 2002 was \$340,000 on a loss before tax of \$1.1 million. The difference between the federal statutory income tax rate and the Company's effective tax rate relates primarily to the nondeductibility of a portion of the \$28.0 million goodwill impairment discussed above, interest expense associated with the PIK Debentures which were retired in the first quarter of 2003, state income taxes, and a disallowance for travel and entertainment expenses.

#### ***Nine Months Ended September 28, 2003 Compared to Nine Months Ended September 29, 2002***

Net sales of services for the nine month period ended September 28, 2003 were \$276.0 million, a decrease of 5.0 % from net sales of services for the nine month period ended September 29, 2002 of \$290.5 million. The Company experienced a decrease in net sales of services in Staff Augmentation and Financial Outsourcing Services segments, partially offset by an increase in the Human Capital Management Services segment. Net sales of services in the Human Capital Management Services segment increased by \$11.6 million or 9.5%, principally due to an increase in its client base. In the Staff Augmentation segment, the decrease of \$24.2 million (15.0%) is principally attributable to reduced sales to IT and telecom customers, as a result of the continuing effects of the soft economy, partially offset by increased sales to healthcare support and technical services customers. Also, principally as a result of the current economic conditions and a reduced client base, net sales of services were lower by \$1.9 million (28.7%) in the Financial Outsourcing Services segment.

Cost of services for the nine month period ended September 28, 2003 was 83.0% of net sales of services as compared to cost of services of 81.8% for the nine month period ended September 29, 2002. The cost of services as a percentage of net sales for the nine month period ended September 28, 2003 increased from the comparable period in 2002 principally as a result of a decrease in permanent placement fees, a decrease in Financial Outsourcing Services revenues, increased competitive pressures impacting fees and higher growth in Human Capital Management Services (which have a higher cost of services as a percentage of net sales of services).

Selling, general and administrative expenses as a percentage of net sales of services were 13.5% for the nine month period ended September 28, 2003, compared to 14.2% for the nine month period ended September 29, 2002. Excluding the \$1.6 million insurance recovery in the first quarter of 2003 related to uncollectible funding and service fees receivable that were written-off in the fourth quarter of 2001, selling, general and administrative expenses as a percentage of net sales of services were 14.1% for the nine month period ended September 28, 2003. Management continued to undertake initiatives to reduce selling, general and administrative costs by renegotiating existing vendor contracts, reducing the size of or closing marginal offices, reducing back office support staff and re-evaluating incentive compensation plans, and has reduced costs as sales decreased. These costs were further reduced by lower commissions as a result of the decrease of sales discussed above.

Operating loss for the nine month period ended September 28, 2003 was \$21.6 million as compared to operating income of \$8.5 million for the nine month period ended September 29, 2002. The decrease in operating income for the nine month period ended September 28, 2003 is principally attributable to the Company's third quarter \$28.0 million write-off related to the impairment of goodwill discussed above and a decrease in sales and gross margins in Staff Augmentation and Financial Outsourcing Services segments, partially offset by the \$1.6 million insurance claim recovery discussed above.

The Company's interest expense for the nine month period ended September 28, 2003 was principally attributable to interest recorded on its bank credit facility (the Whitehall Credit Facility until June 25, 2003 and the PNC Credit Facility thereafter), the Convertible Notes and the Senior Notes and an assessment made in the second quarter of 2003 of \$170,000 of interest as part of a settlement with the IRS in connection with its audit of tax years 1999 through 2001. The interest expense was lower for the nine month period ended September 28, 2003 as compared to the nine month period ended September 29, 2002 principally due to lower market interest rates and lower borrowing levels under the bank credit facilities as well as the retirement of PIK Debentures in the first two quarters of 2003, partially offset by the assessment of interest in connection with the IRS settlement. See "Replacement of Credit Facility" and "Financial Condition, Liquidity and Capital Resources" in this Item 2.

The Company incurred a write-off of deferred financing costs of \$431,000 in the second quarter of 2003 related to the early retirement of the Whitehall Credit Facility.

The gain on debt extinguishment realized by the Company during the nine months ended September 28, 2003 was the result of the Company's repurchase of Senior Notes in the second quarter of 2003, and the Company's exchange and repurchase of PIK Debentures in the first quarter of 2003. As a result of these transactions, the Company recognized a gain on debt extinguishment of \$8.8 million, which includes the reduction of approximately \$277,000 of deferred financing costs, in the first nine months of 2003.

The income tax provision for the nine month period ended September 28, 2003 was \$79,000 on loss before tax of \$23.3 million. The income tax benefit for the nine month period ended September 29, 2002 was \$769,000 on a loss before tax and cumulative effect of a change in accounting principle of \$3.5 million. The difference between the federal statutory income tax rate and the Company's effective tax rate relates primarily to the nondeductibility of a portion of the \$28.0 million goodwill impairment discussed above, interest expense associated with the PIK Debentures, state income taxes, and a disallowance for travel and entertainment expenses. Included in income tax for the nine months ended September 28, 2003 is an assessment of \$975,000 based on an income tax audit by the IRS for tax years 1999 through 2001.

### **Financial Condition, Liquidity and Capital Resources**

The Company generally pays its billable employees weekly for their services, and remits certain statutory payroll and related taxes as well as other fringe benefits. Invoices are generated to reflect these costs plus the Company's markup. These bills are typically paid within 40 days. Increases in the Company's net sales of services, resulting from expansion of existing offices or establishment of new offices, will require additional cash resources.

During the three and nine months ended September 28, 2003, the Company had no off-balance sheet arrangements other than operating leases entered into in the normal course of business, as indicated in the table below. The following table represents contractual commitments associated with operating agreements (excluding interest on debt obligations):

	Payments due by period (in thousands)				
	2003	2004	2005-6	2007	Thereafter
Operating Leases	\$ 3,184	\$ 2,418	\$ 3,157	\$ 1,177	\$ 2,645
PNC Credit Facility--					
principal repayments	--	--	--	32,000	--
Senior Notes - principal					
repayments	--	--	--	85,000	--
Convertible Notes - principal					
repayments	--	--	--	--	7,135
Total	\$ 3,184	\$ 2,418	\$ 3,157	\$ 118,177	\$ 9,780

The Company also had standby letters of credit outstanding at September 28, 2003 in the aggregate amount of \$4.4 million.

During the nine month period ended September 28, 2003, the Company's primary sources of funds to meet working capital needs were from borrowings under the PNC Credit Facility and the Whitehall Credit Facility. Effective June 25, 2003, the Company retired the Whitehall Credit Facility upon entering into the PNC Credit Facility. See "Replacement of Credit Facility" above in this Item 2. Cash and cash equivalents decreased \$1.5 million during the nine-month period ended September 28, 2003. Cash flows provided by operating activities of \$4.6 million were exceeded by cash flows used in financing activities of \$5.4 million and cash flows used in investing activities of \$673,000.

At September 28, 2003, the Company had outstanding \$32.0 million principal amount under the PNC Credit Facility bearing interest at a weighted average rate of 3.87% per annum. At such date, the Company had remaining availability based upon then outstanding eligible accounts receivable of \$24.7 million.

At September 28, 2003, the Company also had outstanding (i) \$85.0 million principal amount of Senior Notes bearing interest at a rate of 12% per annum, (ii) \$7.1 million principal amount of Convertible Notes bearing interest at the rate of 8% per annum, and (iii) had no PIK Debentures outstanding. The Company has sought to improve its balance sheet. In 2003, it has done so principally through the issuance of equity securities in exchange for debt obligations, including the following transactions:

- In February 2003, the Company issued \$6.1 million face amount of its new Series 2003A Preferred Stock having a fair market value of \$4.3 million in exchange for \$12.3 million of its outstanding PIK Debentures (including accrued interest) from a related party and repurchased additional PIK Debentures (\$59,000 including interest) from unrelated parties for a cash payment of \$21,000. As a result of this transaction, the Company recognized a gain on debt extinguishment of \$7.8 million, which includes the reduction of approximately \$240,000 of deferred financing costs, in the third quarter of 2003. Following this transaction, only \$42,000 principal amount of PIK Debentures remained outstanding. Accordingly, principally in order to eliminate the costs associated with the administration of the PIK Debentures, in May 2003, the Company redeemed the remaining PIK Debentures in accordance with the procedures set forth in the indenture. See Note 3 and 7 to the consolidated financial statements.
- In June 2003, the Company repurchased \$2.0 million principal amount of Senior Notes for \$980,000, resulting in a gain on debt extinguishment of \$983,000, which includes the reduction of approximately \$37,000 of deferred financing costs.
- In September 2003, the Company issued 513 shares of its Series 2003B Preferred Stock having an aggregate face amount and fair market value of \$513,000 in exchange for \$2.0 million principal amount of Convertible Notes, plus accrued interest, in a transaction with a related party. See note 3 and 7 to the consolidated financial statements.

Substantially all of the consolidated net assets of the Company are assets of COI and all of the net income that had been generated by the Company was attributable to the operations of COI. Except for permitted

distributions, these assets and any cumulated net income are restricted as to their use by COMFORCE. The indenture governing the Senior Notes imposes restrictions on COI making specified payments, which are referred to as “restricted payments,” including making distributions or paying dividends (referred to as upstreaming funds) to COMFORCE. Under the indenture, COI is not permitted to make cash distributions to COMFORCE other than (1) to upstream \$2.0 million annually to pay public company expenses, (2) to upstream up to \$10.0 million to pay income tax related to deemed forgiveness of PIK Debentures to facilitate the purchase or exchange by COMFORCE of PIK Debentures at less than par, (3) under certain circumstances in connection with a disposition of assets, to upstream proceeds therefrom to repay the PIK Debentures, and (4) to upstream funds to the extent COI meets the restricted payments test under the indenture, the most significant component of which is based upon a percentage of net income generated by COI since January 1, 1998 on a cumulative basis, less prior distributions made in reliance on this provision.

Management believes that \$2.0 million annually (if COI has funds available for this purpose) will be sufficient to pay COMFORCE’s annual public company expenses for the foreseeable future. Principally as a result of losses incurred by COI in fiscal 2002 and the nine months ended September 28, 2003 and prior distributions made by COI to COMFORCE, COI can make no distributions to COMFORCE based upon the cumulative net income provisions of the indenture. It is anticipated that COI must generate net income of approximately \$5.5 million before it will be able to upstream funds to COMFORCE under the restrictive payments test of the indenture. In calculating net income for this purpose, under the terms of the indenture, the Company must apply generally accepted accounting principles as in effect at the time the indenture was entered into in 1997.

Through December 1, 2003, interest on the Convertible Notes is payable, at the option of COMFORCE, in cash or in kind through the issuance of additional Convertible Notes. To date, COMFORCE has paid all interest under the Convertible Notes in kind. Beginning with the interest payment due June 1, 2004, COMFORCE will be required to pay interest on the Convertible Notes in cash. Its ability to do so is expected to be dependent on its availability of funds for this purpose, whether through borrowings by COI under the PNC Credit Facility, funds from COI’s operations or otherwise, and on COI’s ability to upstream funds in accordance with the restricted payments test under the indenture for the Senior Notes. COMFORCE’s ability to repay Convertible Notes at their maturity on December 2, 2009, or on any earlier required repayment or repurchase dates, will also be dependent on any restrictions under its loan agreements as then in effect and availability of funds.

The holder of the Convertible Notes, which is a partnership in which John Fanning, the Company’s chairman and chief executive officer, holds the principal economic interest, has advised that it will agree to extend the payment-in-kind terms or make other mutually acceptable arrangements if the Company does not have adequate availability under the indenture to upstream funds to make cash payments of interest on the Convertible Notes commencing June 1, 2004. The Company expects to pay appropriate consideration to the holder for agreeing to this accommodation as may be negotiated by the parties upon the recommendation of an independent financial advisor.

As of September 28, 2003, approximately \$32.2 million, or 24.5%, of the Company’s total assets were goodwill recorded in connection with the Company’s acquisitions. The Company evaluated the recoverability of goodwill on its books under the new standards under SFAS 142 at its adoption in the first quarter of 2002, resulting in its write-off of \$55.0 million of goodwill in that quarter, again in the fourth quarter of 2002, resulting in an additional write-off of \$19.0 million of goodwill in that quarter, and most recently in the third quarter of 2003 (as described above in this Item 2 under “Goodwill Impairment”), resulting in an additional write-off of \$28.0 million. The Company must test goodwill for impairment in accordance with the provisions of SFAS 142 at least annually. If management’s expectations of future operating results change, or if there are changes to other assumptions, the estimate of the fair value of the Company’s reporting units could change significantly. Such a change could result in additional goodwill impairment charges in future periods, which could have a significant impact on the Company’s consolidated financial statements.

Management of the Company believes that cash flow from operations and funds anticipated to be available under the PNC Credit Facility will be sufficient to service the Company’s indebtedness and to meet currently anticipated working capital requirements throughout 2003. The Company has made significant progress in improving its capital structure, most recently through the elimination of debt in connection with its repurchase of PIK Debentures and Senior Notes and Convertible Notes during the first nine months of 2003, as described above, but no assurance can be given that opportunities to further eliminate high interest rate debt will be available on favorable

terms. The Company currently meets all financial covenants under the PNC Credit Facility and expects to continue to do so at least through the end of fiscal 2003. However, management is uncertain as to whether it will meet such covenants thereafter. In the event that the Company is unable to meet any of such covenants, it anticipates it would receive a waiver or modification, however, there can be no assurances that the Company will be successful in any such request.

### **Impact of Recently Issued Accounting Standards**

In December 2002, the Financial Accounting Standards Board (“FASB”) issued Statement No. 148, *Accounting for Stock-Based Compensation--Transition and Disclosure* (“SFAS 148”). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation as originally provided by Statement No. 123, *Accounting for Stock-Based Compensation* (“SFAS 123”). Additionally, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosure in both the annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. The transitional requirements of SFAS 148 are effective for all financial statements for fiscal years ending after December 15, 2002. The Company adopted the disclosure portion of this statement for the current fiscal quarter ended September 28, 2003. The application of the disclosure portion of this standard did not have any impact on the Company’s consolidated financial position or results of operations. The FASB has indicated that it will require stock-based employee compensation to be recorded as a charge to earnings in the future. The Company will continue to monitor the FASB’s progress on the issuance of this standard as well as to evaluate its position with respect to current guidance.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (“SFAS 150”). This accounting standard establishes standards for classifying and measuring certain financial instruments with characteristics of both liabilities and equity. It requires that certain financial instruments that were previously classified as equity now be classified as a liability. This accounting standard is effective for financial instruments entered into or modified after May 31, 2003, and otherwise at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement did not have a material impact on the consolidated financial statements.

### **Seasonality**

The Company’s quarterly operating results are affected primarily by the number of billing days in the quarter and the seasonality of its customers’ businesses. Demand for technical and engineering services, IT and telecom staffing services has historically been lower during the second half of the fourth quarter through the following first quarter, and, generally, shows gradual improvement until the second half of the fourth quarter.

### **Forward Looking Statements**

Various statements made in this Report concerning the manner in which the Company intends to conduct its future operations, and potential trends that may impact future results of operations, are forward looking statements. The Company may be unable to realize its plans and objectives due to various important factors, including, but not limited to the following: a continuation of the current recessionary environment, particularly in the aircraft manufacturing, telecom, information technology and other sectors served by the Company (which may reflect cyclical conditions or, particularly in the case of telecom, fundamental changes in these industries), could further reduce demand for contingent personnel and further heighten the competition for customers, resulting in lower revenues and margins and affecting the Company’s ability to continue to meet the financial covenants under the PNC Credit Facility; the Company’s significant leverage may leave it with a diminished ability to obtain additional financing for working capital or other capital expenditures, for retiring higher interest rate debt or for otherwise improving the Company’s competitiveness and capital structure or expanding its operations; SFAS 142, which requires the Company to evaluate at least annually the recoverability of goodwill on its books, could cause the Company to write-off goodwill in future periods (in addition to the write-offs of \$74.0 million in 2002 and \$28.0 million in 2003), which could have a material adverse impact on the Company’s financial condition and results of operations; or, if COI fails to generate sufficient consolidated net income (after covering its cumulative deficit at September 28, 2003 of \$5.5 million) or to have other funds available to upstream to COMFORCE under the restricted payments test of the Senior Notes indenture in order for it to pay cash interest on the Convertible Notes

(which is required beginning on June 1, 2004) or to repay the Convertible Notes at their maturity on December 2, 2009, or on any earlier required repayment or repurchase date, then, unless COMFORCE obtains a loan or sells its capital stock or other securities to provide funds for this purpose, the Company will default under the indenture governing the Senior Notes and under the PNC Credit Facility.

Additional important factors that could cause the Company to be unable to realize its plans and objectives are described under "Risk Factors" in the Registration Statement on Form S-8 of the Company filed with the Securities and Exchange Commission on April 24, 2003 (Registration No. 333-104730). The disclosure under "Risk Factors" in the Registration Statement may be accessed through the Web site maintained by the Securities and Exchange Commission at "www.sec.gov." In addition, the Company will provide, without charge, a copy of such "Risk Factors" disclosure to each stockholder of the Company who requests such information. Requests for copies should be directed to the attention of Linda Annicelli, Vice President, Administration at COMFORCE Corporation, 415 Crossways Park Drive, P.O. Box 9006, Woodbury, New York 11797, telephone 516-437-3300.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by Item 3 has been disclosed in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 29, 2002. There has been no material change in the disclosure regarding market risk.

### **ITEM 4. CONTROLS AND PROCEDURES**

The company's management evaluated, with the participation of the chief executive officer and chief financial officer, the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. There has been no change in the Company's internal control over financial reporting that occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

Since the date of the filing of the Company's Annual Report on Form 10-K for the year ended December 29, 2002, there have been no material new legal proceedings involving the Company or any material developments to the proceedings described in such 10-K.

### **ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.**

In September 2003, the Company issued shares of its Series 2003B Preferred Stock having a face amount and fair market value of \$513,000 (513 shares) in exchange for \$2.0 million aggregate amount of the Company's Convertible Notes, plus accrued interest, in a transaction the Fanning Partnership. The Company obtained the opinion of an independent investment banking firm that the terms of the exchange transaction with the Fanning Partnership were fair to the Company from a financial point of view, and the Company's directors approved the terms of the transaction. The consideration paid to the Fanning Partnership in September 2003 for the principal amount of the Convertible Notes exchanged in this transaction was substantially less than the consideration paid by the Fanning Partnership for the securities it had previously exchanged for the Convertible Notes.

As described in note 7 to the consolidated financial statements (which description is incorporated herein by reference), the rights and preferences of the Series 2003A and Series 2003B Preferred Stock are substantially identical except that conversion price is \$1.05 for the Series 2003A Preferred Stock and \$0.54 for the Series 2003B Preferred Stock to convert such shares into common stock (or, in certain circumstances, into a participating preferred stock which in turn will be convertible into common stock at the same effective rate).

These shares of Series 2003B Preferred Stock were issued to the Fanning Partnership in reliance upon the exemptions from registration afforded by section 3(a)(9) or section 4(2) of the Securities Act of 1933 and the regulations thereunder. Unless the Company registers the shares of common stock issuable upon conversion of the Series 2003A Preferred Stock for resale under the Securities Act of 1933, any resale of those shares by the Fanning Partnership, as an affiliate of the Company, will be conducted in compliance with the volume limitations and other conditions of Rule 144 of the Securities Act of 1933 (other than the holding period requirement).

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

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

On August 13, 2003, the annual meeting of the stockholders of the Company was held. At this meeting, the stockholders holders voted on (1) the election of directors, with each to serve for a term of one year, and (2) the approval of the Company’s issuance of 13,650,000 additional shares of common stock, and (3) ratification of the appointment of KPMG LLP as the Company’s auditors for the year ending December 28, 2003.

The following individuals were elected to the Board of Directors upon the vote shown:

<i>Nominee</i>	<i>For</i>	<i>Withheld</i>
John C. Fanning	15,418,868	172,075
Harry V. Maccarrone	15,518,868	171,975
Rosemary Maniscalco	15,449,175	141,768
Kenneth J. Daley	15,449,181	141,762
Daniel Raynor	15,552,690	38,253
Gordon Robinett	15,449,183	141,760

The stockholders approved the Company’s issuance of 13,650,000 additional shares of common stock:

<i>For</i>	<i>Against</i>	<i>Abstained</i>	<i>Broker Non-Votes</i>
8,455,334	1,537,645	4,072	5,593,892

The stockholders approved the Company’s the appointment of KPMG LLP as the Company’s independent certified public accountants:

<i>For</i>	<i>Against</i>	<i>Abstained</i>	<i>Broker Non-Votes</i>
15,574,595	12,613	3,735	--

**ITEM 5. OTHER INFORMATION.**

Not applicable.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.**

(a) Exhibits.

3.1 Amended and Restated Certificate of Designation and Determination of Rights and Preferences of Series 2003A and 2003B Convertible Preferred Stock of COMFORCE Corporation filed with the Secretary of State of Delaware on October 6, 2003.

31.1 Certification of chief executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of chief financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of chief executive officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of chief financial officer pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

The Company filed a current report on Form 8-K on August 8, 2003 to furnish its press release reporting results for the quarter ended June 29, 2003.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, each Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunder duly authorized.

COMFORCE Corporation

By: /s/ Harry V. Maccarrone  
Harry V. Maccarrone,  
Executive Vice President and Chief Financial Officer

Date: November 12, 2003

**CERTIFICATION**  
**Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, John C. Fanning, Chairman and Chief Executive Officer of COMFORCE Corporation, hereby certify that:

1. I have reviewed this quarterly report on Form 10-Q of COMFORCE Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (i) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (ii) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (iii) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (i) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ John C. Fanning  
John C. Fanning,  
Chairman and Chief Executive Officer

**CERTIFICATION**  
**Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Harry V. Maccarrone, Executive Vice President and Chief Financial Officer of COMFORCE Corporation, hereby certify that:

1. I have reviewed this quarterly report on Form 10-Q of COMFORCE Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (i) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (ii) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (iii) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (i) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2003

/s/ Harry V. Maccarrone

Harry V. Maccarrone,  
Executive Vice President and Chief Financial Officer

**CERTIFICATION**  
**Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned officer hereby certifies that, to his knowledge, (1) the Quarterly Report on Form 10-Q of COMFORCE Corporation for the quarter ended September 28, 2003 as to which this Certification is an exhibit fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and (2) the information contained in such Report fairly presents, in all material respects, the financial condition and results of operations of COMFORCE Corporation.

Signed this 12th day of November, 2003.

/s/ John C. Fanning  
John C. Fanning,  
Chairman and Chief Executive Officer

**CERTIFICATION**  
**Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

The undersigned officers hereby certifies that, to his knowledge, (1) the Quarterly Report on Form 10-Q of COMFORCE Corporation for the quarter ended September 28, 2003 as to which this Certification is an exhibit fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and (2) the information contained in such Report fairly presents, in all material respects, the financial condition and results of operations of COMFORCE Corporation.

Signed this 12th day of November, 2003.

/s/ Harry V. Maccarrone

Harry V. Maccarrone,  
Executive Vice President and Chief Financial Officer