

June 2, 2005

## COMPUTER HORIZONS CORP.

Nasdaq: CHRZ

Rating: Speculative Buy Maintained

18-month Price Target: \$7.0

Symbol	CHRZ
Recent Price (06/01/05)	\$2.97
Low/High 52 weeks	\$2.62/\$4.72
Average Volume (3m)	109,751
Market Capitalization	\$93 Mn
Shares Outstanding	31.2 Mn

Source: Yahoo! Finance, SEC filings

**We are reiterating our Speculative Buy Rating on CHRZ following the submission of form S-4 with the SEC. Although there is a degree of uncertainty regarding the completion of the merger, and arguably CHRZ paid a premium to “acquire” ANLY, we incline to believe that the merger has certain strategic long-term merits. Our 18-month price target, based on a financial model, is 135% above the current share price, suggesting tremendous upside potential, however, the multitude of risks related to merger call for a “speculative” qualification of the rating. The merger will not come cheap, with \$11-12 million in transaction costs and dilution of the differentiated RGII and Chimes divisions; however we tend to agree with management that size matters. A larger company may benefit from economies of scale, enjoy superior bargaining power in the market and have better visibility with the investment community.**

On May 31, 2005, CHRZ submitted with the SEC Form S-4 in connection with the announced merger with ANLY, which we mentioned in our previous reports. The Form is not final and may be amended at any time, while the merger itself is still subject to the approval from each company’s shareholders and from antitrust law enforcing government bodies. The form discloses detailed information about the merger and provides some insight into the financial implications of this transaction. Thus, pursuant to the merger agreement, CHRZ’s wholly-owned subsidiary JV Merger Corp. will be merged with and into ANLY with ANLY being the surviving entity in the merger and resulting in ANLY becoming a wholly-owned subsidiary of CHRZ. Each share of ANLY’s common stock issued and outstanding immediately before the effective time of the merger will be converted in the right to receive 1.15 shares of CHRZ’s common stock. Therefore, CHRZ has registered with the SEC an additional 31,414,235 shares to be exchanged for ANLY’s shares when the merger takes place. The management expects that the merger will bring annual savings of approximately \$15 million to the new company, while taking revenues to new heights – beyond \$600 million annually.

### Valuation

COMPANY NAME	Ticker	Share Price 5/31/05	M Cap, \$m 5/31/05	Price to Book	EV/ EBITDA	PE ttm	PE 2006	PSR ttm	PSR 2006
<b>COMPUTER HORIZONS</b>	<b>CHRZ</b>	<b>2.97</b>	<b>93</b>	<b>0.74</b>	<b>9.00</b>	<b>N/A</b>	<b>7.34</b>	<b>0.25</b>	<b>0.14</b>
ACCENTURE	ACN	23.28	21,840	11.50	7.60	17.60	14.70	1.46	1.28
ELECTRONIC DATA SYS	EDS	19.70	10,198	1.40	4.30	49.20	29.40	0.50	0.51
ADECCO SA ADR	ADO	11.92	8,902	3.70	10.30	20.90	13.50	0.40	N/A
COMPUTER SCIENCES	CSC	46.31	8,850	1.30	5.20	15.90	14.20	0.59	0.59

MANPOWER	MAN	39.83	3,580	1.60	8.20	16.50	12.50	0.23	0.20
MPS GROUP	MPS	9.38	962	1.10	11.30	24.70	15.10	0.63	0.51
KELLY SERVICES 'A'	KELYA	27.81	988	1.50	11.60	39.70	14.00	0.19	0.16
KEANE	KEA	13.42	832	1.80	7.80	20.60	17.20	0.90	0.76
CIBER	CBR	8.15	509	1.40	9.40	15.40	12.90	0.56	0.51
CDI	CDI	21.34	420	1.60	18.30	41.80	19.40	0.40	0.35
COMPUTER TASK GROUP	CTG	3.50	73	1.30	14.20	21.90	11.70	0.30	0.24
COMFORCE	CFS	1.94	33	NM	8.70	NM	N/A	0.07	N/A
<b>Average</b>		<b>18.88</b>	<b>4,766</b>	<b>2.56</b>	<b>9.74</b>	<b>25.84</b>	<b>15.87</b>	<b>0.52</b>	<b>0.51</b>
<b>... excl. outliers</b>		<b>18.88</b>	<b>4,766</b>	<b>1.44</b>	<b>9.74</b>	<b>23.50</b>	<b>14.52</b>	<b>0.56</b>	<b>0.51</b>
<b>Median</b>		<b>16.56</b>	<b>975</b>	<b>1.50</b>	<b>9.05</b>	<b>20.90</b>	<b>14.20</b>	<b>0.45</b>	<b>0.51</b>
<b>Employment services</b>	-	<b>14.33</b>	<b>998</b>	<b>2.30</b>	<b>10.80</b>	<b>23.30</b>	<b>18.80</b>	<b>0.37</b>	<b>0.45</b>
<b>IT consulting &amp; Services</b>	-	<b>13.06</b>	<b>1,334</b>	<b>3.20</b>	<b>13.40</b>	<b>30.80</b>	<b>19.10</b>	<b>1.24</b>	<b>1.11</b>
<b>Data processing Services</b>	-	<b>26.32</b>	<b>4,095</b>	<b>4.70</b>	<b>10.90</b>	<b>27.80</b>	<b>21.10</b>	<b>1.77</b>	<b>1.58</b>
S&P 500		1191.50	91,526	2.80	N/A	17.20	15.60	1.49	N/A
NASDAQ COMPOSITE		2068.22	52,264	3.70	N/A	28.00	21.90	4.18	N/A

Source: Baseline, Yahoo! Finance, Analyst Estimates

We believe that at the current share price CHRZ represents a superior investment opportunity. Even though the company has decided to postpone the moment of return to profitability in order to pursue a longer-term strategic plans, we still believe that it is trading a meaningful and unjustified discounts to peers. Under our financial assumptions, and following the merger with ANLY, the company is trading at a mere 7.3x its FY06 net income per share. The FY06 price-to-sales ratio of 0.14x is at a huge discount to the industry and even the costs of integration and the dilution of ownership in the "hot" RGII and Chameleon divisions are not justification enough to have CHRZ's stock at the current share price.

### DCF Analysis

*All figures in '000s USD, except per share data*

#### **MAJOR ASSUMPTIONS**

Stock Price	\$2.97	Beta	1.09
Shares Outstanding, 000s end-of-FY06	60,487	Risk Premium	4.0%
Book Value of Net Debt, \$000s	\$0.00	Risk Free Rate (10 yr bond)	4.5%
Weighted Cost of Equity	9.9%	Small Cap Premium	1.0%
Long-term Equity Weight	100%	Cost of Equity	9.9%
WACC	9.9%	Terminal growth	4.0%

The inputs into the DCF model taken from the financial model for the combined entity are as follows:

<b>000s USD</b>	<b>FYE05</b>	<b>FYE06</b>	<b>FYE07</b>	<b>Terminal Value</b>
EBIT (1-T)	1,408	24,281	29,137	
Dep & Amort	8,605	8,964	9,233	
(-) Cap Ex	(6,083)	(7,798)	(8,733)	
(-) Changes in Non Cash Working Capital	(58)	(2,305)	(500)	
<b>Free Cash Flow</b>	<b>3,872</b>	<b>23,142</b>	<b>29,137</b>	<b>310,266</b>

Finally, the current fair value per share is \$5.35:

#### **Discounted Cash Flow**

DCF stream	44,674
DC terminal value	234,000
Total DC Enterprise Value	278,673

(Less) Interest Liabilities	(45,000)
Equity Value	323,673
Equity Value Per Share	<b>\$5.35</b>

### Price Target

As done in the initiation report, we will calculate sum-of-parts multiples for CHRZ to reflect the value of the business more accurately. The merged entity will however have different business segmentation as ANLY comes with more of the basic/ undifferentiated revenues. We are estimating that FY06 revenues will be composed of 53% IT services, 42% Solutions and 5% Chimes. The forward ratios for the price target multiple derivation will be kept the same as in the initiation report:

	<i>Weight</i>	Forward PE	Forward PSR	EV/EBITDA
IT Services	53%	14.5	0.5	9
Solutions Group	42%	16.0	0.7	10
Chimes	5%	25.0	3.0	15
<b>TOTAL</b>	<b>100%</b>	15.6	0.7	9.7

Using the new sales structure and ratios, our ratio-based price target calculations are as follows:

\$0.40 EPS FY06	x	15.6x forward PER	=	\$6.24 price target
\$10.86 Sales per share FY06	x	0.7x forward PSR	=	\$7.60 price target
\$39.7M EBITDA FY06	x	9.7x EV/EBITDA ratio	=	\$385.1M EV or \$7.17 price target*

\*Assuming end-of-FY06 cash balance of \$45 mil and 60 million shares outstanding

THE PRICE TARGET IS AN EQUAL WEIGHTED AVERAGE OF THE PRICES DERIVED UNDER THE THREE METHODOLOGIES ABOVE – NAMELY \$7.0. COMBINED WITH THE

### **Merger Rationale**

The combined S-4 submission cited the following motives for the merger:

- create a combined company with greater financial strength with revenues of approximately \$600 million based on 2004 revenues;
- create a combined company with increased capitalization which is better positioned to leverage its capital to grow its businesses and respond more quickly to industry changes and competitive pressures in the marketplace;
- reduce, as a percentage of revenue, selling, general and administrative expenses and costs of operating a public company;
- yield cost synergies estimated at \$15 million on an annual basis;
- create potential revenue opportunities with cross-selling and greater geographic footprint;
- provide new market opportunities for each company's unique and complementary products and services;
- improve the ability to compete for staffing contracts at Fortune 500 companies; and
- increase visibility in the investor community and the ability to leverage each company's respective resources, services and markets to pursue further growth opportunities.

We feel that the reasons above are valid and compelling. Both companies have suffered a serious blow in the after-math of the internet bubble with both business shrinking and valuations falling. At the current size the two companies are somewhat in a limbo, because their market cap leaves them off the radars of many investment houses. Moreover, as the industry continually evolves, consolidates and migrates offshore, it is likely that a combined CHRZ-ANLY entity will have more negotiation power and contract-generation

capabilities than any company on a standalone basis. Moreover, from a “statement of operations” point of view, the merger definitely makes sense because it halves the cost of being public – an increasingly significant burden cited recently by many small and medium-sized listed companies.

The management mentioned that the current geographic focus allows for a synergistic combination, because CHRZ has a significant presence in the eastern half of the U.S. and ANLY has a significant presence in the midwest of the country. The two companies can combine their strengths in particular geographic areas and enhance each other’s reach in those areas. Moreover, judging by the recent acquisition history of ANLY, we find ANLY management interested in and focused on the new trends in the industry and believe that a combined CHRZ-ANLY management team may add value to the whole organization just because there will be a richer pool of ideas. Of course, there is a risk of integration, both at the lowest levels, as well as at the top level, however the current non-dual top-management structure seems to minimize the risk of conflicts.

A recurring motive for the merger cited by the management of both companies is critical mass as “a key component to achieving competitiveness in the industry since size had become a significant factor in achieving preferred vendor status.” In fact we feel that aside from market cap reasons, it was the main rationale for the merger. Bigger is better, at least at the present moment in the IT consulting industry. Economies of scale and efficiency are required to stay afloat and be competitive in an environment where pay-bill spreads fall and many IT projects are outsourced from low-cost countries. CHRZ and ANLY decided to combine operations to try to better compete with the larger and more established industry players.

### **The Merger Process**

In a memo to CHRZ’s and ANLY’s employees on May 27, 2005 (filed with the SEC as Form 425 on May 27), the merger process was described to flow in three phases. Phase I began with the merger announcement in April and concluded by May 27 with the finalization of the integration planning roadmap. Up to this point, the integration scope, methodology, synergies, interdependencies and communication plans had been defined, and the companies were ready to launch functional planning teams in HR, Legal, Finance, Accounting, Shared Services, IT, Marketing/IR, Facilities and Field Operations. A Program Management Office has been established that will serve as the central place for all integration planning activities. Phase II (Detailed Integration Planning) is expected to be concluded by mid-July, prior to the final merger approval, and Phase III (Implementation) will only begin after the merger is officially approved and it may take through the balance of the year to complete, according to Randy Verdino – the Integration Planning Leader overseeing all merger related planning activities between ANLY and CHRZ.

### **Merger Conditions**

The merger is subject to the following conditions:

- the declaration of effectiveness of the registration statement relating to registration of shares of CHRZ’s common stock by the Securities and Exchange Commission;
- the approval of the merger by ANLY’s shareholders and the approval of the issuance of the shares of CHRZ’s common stock issuable to ANLY’s shareholders in the merger by CHRZ’s shareholders;
- the expiration or earlier termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976;
- the approval for listing or quotation on Nasdaq of the shares of CHRZ’s common stock to be issued to ANLY’s shareholders in the merger;
- the absence of any material adverse effect (as defined in the merger agreement) as to either company’s business, results of operations, properties or financial condition taken as a whole; and
- the receipt by each company of an opinion of counsel that the merger will be treated for federal income tax purposes as a reorganization.

Either CHRZ or ANLY may waive the conditions to the performance of its respective obligations under the merger agreement and complete the merger even though one or more of these conditions have not been met.

### **Merger Agreement Termination Conditions**

Under circumstances specified in the merger agreement, either CHRZ or ANLY may terminate the merger agreement. Subject to the limitations set forth in the merger agreement, the termination circumstances generally include:

- mutual written consent of each company;
- the merger not being completed on or before November 30, 2005;
- a non-appealable final order of a court or other action of any governmental authority has the effect of permanently prohibiting completion of the merger;
- the failure of either ANLY's or CHRZ's board of directors to recommend approval of the merger by its shareholders, the recommendation of a third-party acquisition proposal by either board of directors or the failure to hold a special meeting; or
- either (1) a failure of the shareholders of either company to approve the merger, (2) the failure of either company's representations and warranties to be true, or (3) the failure by one company to fulfill certain conditions to the other company's obligations to occur.

Generally, all fees and expenses incurred by each company in connection with the merger will be paid by the company incurring such expenses whether or not the merger is consummated, except that CHRZ and ANLY shall share equally all fees and expenses, other than attorneys' and accountants' fees and expenses, incurred (i) in or relating to the printing and mailing of the joint proxy/prospectus or (ii) in connection with the filing of the pre-merger notification and report forms under the HSR Act. If the merger is not completed under certain of the circumstances described above as specified in the merger agreement, CHRZ or ANLY may be responsible to pay to the other a termination fee of \$3.6 million and to reimburse the other company's out-of-pocket expenses relating to the merger (up to a maximum of \$1 million).

### **Merger Costs**

CHRZ estimates that it will incur direct transaction costs of approximately \$2.65 million associated with the merger, which will be included as part of the total purchase price for financial accounting purposes, and has reserved an additional \$0.5 million to be paid to select employees as retention bonuses. In addition, ANLY estimates that it will incur direct transaction costs of approximately \$7.822 million, which will be recognized and expensed as incurred, and has reserved an additional \$0.5 million to be paid to select employees as retention bonuses. In the aggregate, approximately \$5,897,000 of this is attributable to change of control payments to officers of ANLY. Additionally, ANLY expects to compensate employees who agree to waive change of control provisions in their employment agreements in the form of restricted stock and cash payments. These waivers are currently being negotiated. The aggregate cost of all of these waivers is expected to be within a range of \$2.0-2.5 million. Thus, the total expected transaction costs of the merger may be as high as \$11.5 million – this amount excludes the costs of realigning both organizations to function as a new company.

### **Merger Risks**

There are numerous risks related to the proposed merger, but we are going to mention just a few of them – management has done a good job of elaborating on most of them in the submitted form S-4.

We believe that the greatest risk CHRZ faces at the moment is the ability to finalize the transaction. Judging by the dynamics of the share price since the announcement of the merger, the market has not taken on the news favorably.

The stock is now trading at 20% below the 200-day moving average and 37% below the 52-week high share price. The fall in the share price came in the first weeks of April, coinciding with the merger announcement. It has been argued that the price may not favor CHRZ and that it might have been a better idea to purchase ANLY outright. The current share price seems to indicate increase investor weariness regarding the merger and in case the current shareholders of CHRZ (or ANLY for that matter) decide to vote against the transaction, CHRZ will have to face a \$3.6 million termination fee in addition to various other expenses incurred to date or afterwards.



Should the transaction be approved by both parties, and go through, there will be a significant initial cost – up to \$11-12 million – in addition to which there will be an increased SGA expense of aligning the two entities in terms of personnel and business direction. So, of the expected \$15 million annual cost saving, we believe none will be realized in the first year of joint operations, because it will approximately equal to the total cost of the merger (including transaction costs and reorganization/ severance and other costs).

Additionally, some of the specific details of the post-merger period remain unclear. For example, we know that the CHRZ-ANLY headquarters would be located in Minneapolis, Minnesota with financial and accounting operations being based in New Jersey. However, the recently submitted form S-4 stated that the new entity will have a new name – as a result we can assume that the company will also seek to reposition itself to better reflect its increased breadth of offering and customer outreach. That change may or may not be beneficial, although it is hard to expect further price decreases of the stock from the current levels. We believe that the risks involved in the transaction justify a “speculative” qualification to the rating, but that the current share price validates a “buy” rating.

**Sergiu Lisnic, CFA** is a Senior Analyst with Spelman Research. Prior to joining the company, he worked as an analyst for Evanston Capital Advisors for a year and a half, and subsequently served for two years as a financial analyst with a gas distribution and a FMCG company. He was primarily responsible for financial statement analysis, budgeting and reporting to shareholders. He earned the CFA title in September 2003.

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## Financial Projections

Statement of Operations*	2004	Q1FY05E	Q2FY05E	Q3FY05E*	Q4FY05E*	2005E*	2006E*
USD '000, for the period ended	31-Dec-04	31-Mar-05	30-Jun-05	30-Sep-05	31-Dec-05	31-Dec-05	31-Dec-06
IT Services	131,204	48,671	-	-	-	-	-
Solutions Group	108,231	11,539	-	-	-	-	-
Chimes	23,092	6,363	-	-	-	-	-
<b>TOTAL REVENUES</b>	<b>262,527</b>	<b>66,573</b>	<b>69,803</b>	<b>73,769</b>	<b>158,334</b>	<b>368,479</b>	<b>660,278</b>
<b>COSTS AND EXPENSES:</b>							
IT Services	106,591	-	-	-	-	-	-
Solutions Group	72,619	-	-	-	-	-	-
Chimes	1,396	-	-	-	-	-	-
Direct costs	180,605	45,588	47,640	49,947	118,669	261,844	493,150
Selling, general and administrative	85,141	20,977	21,657	22,038	35,397	100,070	133,620
Amortization of intangibles	1,695	350	483	483	676	1,992	2,812
Restructuring charges	2,859	-	1,000	2,150	250	3,400	-
Special charges (credits)	19,367	(675)	-	-	-	-	-
Total cost & expenses	289,668	66,240	70,780	74,618	154,992	366,631	629,582
INCOME/(LOSS) FROM OPERATIONS	(27,141)	333	(977)	(849)	3,342	1,848	30,696
<b>NORMALIZED OPERATING INCOME</b>	<b>(4,914)</b>	<b>(342)</b>	<b>23</b>	<b>1,301</b>	<b>3,592</b>	<b>5,248</b>	<b>30,696</b>
<b>Total OTHER INCOME / (EXPENSE):</b>	<b>(676)</b>	-	-	-	-	-	-
INCOME/(LOSS) BEFORE INCOME TAXES	(27,817)	30	30	30	-	-	-
Income tax	(2,690)	-	-	-	-	-	-
		30	30	30	56	146	224
INCOME / (LOSS) BEFORE MINORITY INTEREST	(25,127)						
Minority Interest	(45)	508	(947)	(819)	3,398	1,994	30,920
NET INCOME / (LOSS)	(25,172)	178	(332)	(287)	-	(441)	(6,415)
<b>Key Financials</b>							
EBITDA	(20,625)	330	(615)	(533)	3,398	2,435	24,505
Operating Margin	-10.3%	-	-	-	-	-	(30)
Net Profit Margin	-9.6%	-	-	-	-	-	-
EBITDA margin	-7.9%	330	(615)	(533)	3,398	2,435	24,475
<b>Per Share statistics</b>							
Net Loss Basic & Diluted	(\$0.82)	1,890	713	1,087	5,278	8,969	39,660
SHARES OUTSTANDING:	30,870	0.5%	-1.4%	-1.2%	2.1%	0.5%	4.6%

\*ANLY operations are included starting with Q4FY05