

November 7, 2005

COMPUTER HORIZONS CORP.
Nasdaq: CHRZ
Rating: Speculative Buy Maintained

Symbol	CHRZ
Recent Price (11/04/05)	\$4.16
52wk Range	\$2.62-\$4.56
Average Volume (3m)	203,085
Market Capitalization	\$130.03 Mn
Shares Outstanding	31.3 Mn

Source: Yahoo! Finance, SEC filings

We maintain our Speculative Buy rating on CHRZ. For CHRZ, the last several months were dominated by a battle between CHRZ's management and a group of shareholders (calling themselves "the Computer Horizons Full Value Committee") who opposed the merger with ANLY and demanded the resignation of the Board of Directors and the appointment of their own candidates. Eventually, the merger with ANLY did not happen, as CHRZ's management failed to persuade the majority of the company's shareholders to support the deal. Consequently, according to the terms of the merger agreement, CHRZ may be liable to a termination fee of \$3.6 million plus up to \$1 million compensation of ANLY's merger expenses. Subsequent to the merger failure, almost three quarters of shareholders voted to replace the Board of Directors in its entirety. We will revisit our rating and price target once the impact of the Board change on the company's course and operating results can be assessed.

RECENT EVENTS

Merger with ANLY Failed

On September 7, 2005, the Agreement and Plan of Merger between CHRZ, ANLY and JV Merger Corp. (a wholly-owned subsidiary of CHRZ) terminated without consummation. The termination resulted from the failure of CHRZ to receive the requisite vote of its shareholders.

Management Board Replaced

On October 11, shareholders voted to remove existing Chairman, Earl Mason, and existing Directors William Murphy, William Marino, William Duncan, Eric Edelstein and Edward J. Obuchowski from the Board without cause. The shareholders also voted to fix the number of directors comprising the board at 5 and elected Full Value Committee's nominees Eric Rosenfeld, Karl L. Meyer, Robert F. Walters, Frank J. Tanki, and Willem Van Rijn to the Board of Directors. The Full Value Committee demanded that shareholders voted to replace the current Board of Directors with new managers selected by the Committee following the dispute regarding the merger with ANLY.

Computer Horizons Retains Jefferies Broadview to Explore Strategic Alternatives

On September 29, CHRZ announced that it has retained Jefferies Broadview to assist in the reassessment of various strategic alternatives to maximize shareholder value, including, the sale of all or certain parts of the Company, a spin-off or IPO of certain assets, purchase of assets, potential mergers, acquisitions and a stock repurchase program.

New Contracts

While shareholders were deciding whose side they are on, CHRZ's subsidiary RGII Technologies was doing business. Thus, on August 2, RGII announced that it had been awarded a five-year contract by the Smithsonian Institution to provide development support for the National Museum of Natural History's new Ocean Web Portal.

On August 30, it was selected as part of a team to provide program support to the Multi-Mission Helicopters Program Office, PMA-299, located at the Naval Air Systems Command (NAVAIRSYSCOM) in Patuxent River, MD. The value of this contract to RGII Technologies is approximately \$2.6 million over five years.

On September 12, RGII Technologies was selected by the US Navy's Naval Sea Systems Command as one prime contractor to provide integrated support for aviation, surface, and undersea warfare. The contract has a total potential value of \$33 billion over its five-year base period and two five-year option periods. The SeaPort Rolling Admissions Multiple Award Contract becomes effective within the next two months. The team will compete to provide support services in 21 functional areas. RGII's expertise in all phases of naval weapon systems acquisition and life cycle support will allow the team to propose and employ solutions to Navy systems challenges.

On November 2, RGII Technologies announced that it had won a five-year contract from the U.S. Department of the Navy to provide decision support services for the Naval Medical Information Management Center (NMIMC). RGII was on the winning team led by Bay Technologies Consulting Group that will sustain the NMIMC's Navy Medical Data Quality program. As part of the contract, RGII will maintain and improve the information systems that support Navy staff at the Bureau of Medicine and Surgery (BUMED) and the Naval Military Treatment Facilities (MTF).

Also, in July RedTail Solutions Inc. was acquiring data synchronization technology from CHRZ. The companies did not disclose financial terms of the deal.

MANAGEMENT TEAM

As was mentioned above, due to a vote of shareholders, the whole Board of Directors was changed. The new members of the Board are as follows: Eric Rosenfeld as non-executive Chairman of the Board, Dennis J. Conroy as President and Chief Executive Officer, and Brian A. Delle Donne as Chief Operating Officer.

Eric Rosenfeld, 48, has served as the managing member of the general partner of Crescendo Partners, L.P., a New York-based investment firm, since 1998. Mr. Rosenfeld was a managing director at CIBC Oppenheimer and its predecessor company for 14 years prior to that. Mr. Rosenfeld is currently and has been on the boards of several other technology related companies.

Dennis Conroy, 60, served in various leadership roles at management consulting firms, bringing 30 years of management and leadership experience to Computer Horizons. From 1998 through 2003, Mr. Conroy held various leadership positions, including membership in Price Waterhouse Coopers' North American Executive Leadership Team, and CEO of PWC's West Business Unit. Prior to joining Price Waterhouse Coopers, Mr. Conroy served as vice president of Booz/Allen/Hamilton, Inc.'s communications and technology practice, as well as managing partner of the National Information – Communications Industry Practice at Coopers & Lybrand.

Brian Delle Donne, 48, brings significant turnaround and mergers and acquisitions experience to CHRZ. Mr. Delle Donne served as Chief Operating Officer of RCM Technologies, Inc., a professional services company delivering IT and engineering solutions to solve client business challenges, since 1998. Mr. Delle Donne was also president of Knight Facilities Management, a subsidiary of a privately-held global engineering and management consulting firm and a senior vice president at Ogden Projects Inc.

Prior Management Changes

On September 16, John E. Ferdinandi, Corporate Controller and Principal Accounting Officer of CHRZ, resigned in order to pursue an opportunity outside of the company. Mr. Ferdinandi's resignation was not due to a disagreement with the company on any matter. Effective September 16, 2005, Michael J. Shea, CHRZ's current Chief Financial Officer, assumed the additional responsibilities of interim Corporate Controller and Principal Accounting Officer. Mr. Shea will serve in such capacity until a successor is named for Mr. Ferdinandi.

On September 12, CHRZ announced that L. White Matthews III was resigning from the company's Board of Directors in order to devote more time to other business commitments. Mr. Matthews had been a member of the Board since 2004. Mr. Matthews was one of two directors who had voluntarily agreed to step down from the Board and would not have been a director of the combined company had the merger with ANLY been consummated. In anticipation of the approval and completion of the proposed merger, Mr. Matthews reorganized his professional commitments including accepting a position on another Board.

On August 29, RGII Technologies announced that John W. Wayne III has joined the company as Vice President of Business Development. Mr. Wayne has 16 years of executive management experience and nearly 30 years of technical and management experience including all aspects of systems integration, systems development and technical service delivery to various federal agencies and branches of the DOD. Most recently, Mr. Wayne was director of operations for Integic Corporation, a leading provider of software applications and business process management solutions. While at Integic, he oversaw all operations of the Uniformed Services Practice Area, managing day- to-day operations and expanding existing business and growing new business opportunities in the DOD. Prior to Integic, Mr. Wayne was a vice president at Northrop Grumman Information Technology (NGIT), Federal Data Corporation, where he led and managed the 150 employee, \$80M Systems and Solutions Division within the Government Solutions Organization of NGIT.

Litigations

In its latest 10Q report, CHRZ announced that in July 2005, it received notification that a former financial advisor to the company had asserted a claim for at least \$1.75 million in amounts allegedly owed to it in connection with the proposed merger with ANLY. The former advisor claims that, pursuant to the terms of its engagement arrangement with CHRZ which is expired, it had the right to act as exclusive financial advisor to CHRZ with respect to certain transactions involving the company such as the proposed merger, notwithstanding the expiration of its engagement. Management believes that the resolution of this matter will not have a material adverse effect on the company's financial position or results of operations.

FINANCIAL PERFORMANCE

Income Statement

Q2FY05 was not a bad quarter for CHRZ in terms of financial performance, but it wasn't spectacular either. The revenue increased by 5% year-over-year, while the net income actually fell and EPS remained at the zero mark. Actually, the change in the net income, as well as the net income itself, were so small in absolute terms that it can hardly be called a decline. Rather, it was a flat zero, just like the EPS, which derives from it. The flat bottom line despite the revenue growth was the result of margins erosion, which fell both year-over-year and quarter-over-quarter.

\$'000, except per share data Financial year ends Dec. 31	Q2FY04	Q2FY05	YoY Change	Q1FY05	Q2FY05	QoQ Change
Revenue	65,790	69,066	5.0%	66,573	69,066	4%
Gross Profit	21,283	21,303	0.1%	20,985	21,303	2%
Operating Income	148	(54)	n/m	333	(54)	n/m
Net income	125	44	-64.8%	330	44	-87%
Diluted EPS, \$	0.00	0.00	0%	0.01	0.00	-100%
Gross Margin	32.3%	30.8%	-1.5 pp.	31.5%	30.8%	-0.7 pp.
Operating Margin	0.2%	-0.1%	-0.3 pp.	0.5%	-0.1%	-0.6 pp.
Net Margin	0.2%	0.1%	-0.1 pp.	0.5%	0.1%	-0.4 pp.

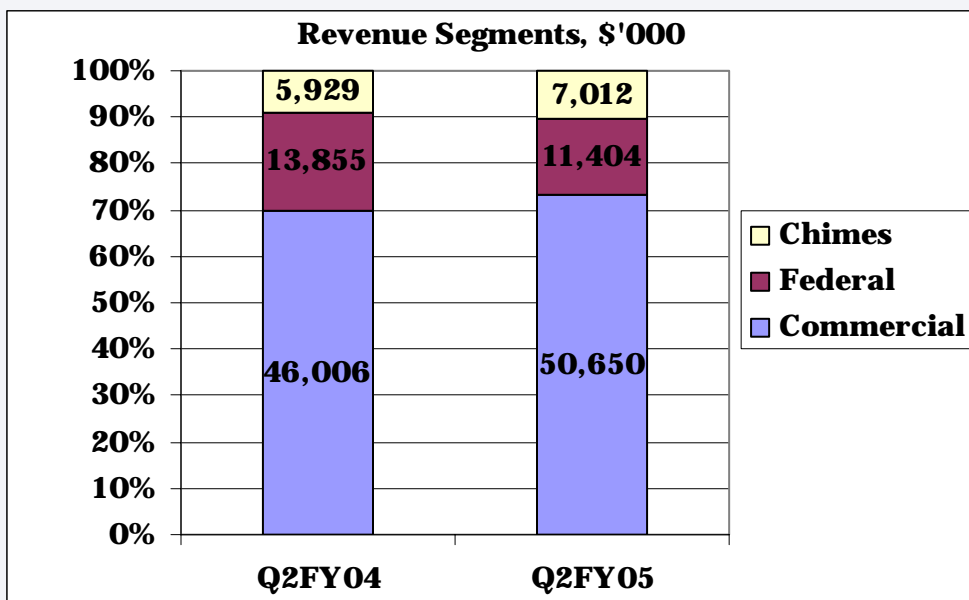
Source: SEC filings

Segment-wise, the erosion of the gross margin in the Commercial segment was primarily attributable to gross margin reductions in the Staff Augmentation business due to continued pressure on average bill rates within this business. On the other hand, the gross margin for the Chimes segment increased due to “improved leveraging of direct costs”.

The operating margin erosion came despite the reduction of SG&A expenses, which fell by 1.6%, or by 2.1 percentage points, from 32.8% to 30.7% of sales revenue. CHRZ explains this decrease by cost reductions resulting from the Q4FY04 restructuring in connection with the company’s business model realignment. Nonetheless, this cost reduction was overwhelmed by the reduction in Special credits from \$939,000 to \$115,000.

Revenue Mix

The revenue mix underwent a slight change, with the Federal segment giving up its share to the Commercial and Chimes lines of business. This shift was a result of a year-over-year reduction in Federal revenues of 17.7%, which CHRZ explains by the transition of restricted contracts, customer/agency budget cuts and delays in funding. The other two business segments, on the other hand, increased. The Commercial segment grew by 10.1% and Chimes – by 18.3% year-over-year. CHRZ attributes the increase in the Commercial Group revenues to an increase in average consultant headcount of approximately 5%, along with improved utilization in comparison to the second quarter of 2004.



Source: SEC filings

Balance Sheet

The balance sheet hardly changed during Q2FY05.

\$'000	Q1FY05	Q2FY05	Change
Cash & Equiv.	31,373	35,854	14.3%
Net Working Capital	68,985	66,839	-3.1%
Total Assets	154,939	160,923	3.9%
Debt	0	0	0%
Shareholders' Equity	126,064	126,122	0.0%

Source: SEC filings

The cash balance increase stands out, however, we can expect it to fall during Q3FY05 due to the expenses associated with the failed merger with ANLY, which, apart from \$2.4 million of recorded charges, can bring an additional \$4.6 million charge in termination and compensation fees to ANLY. Additionally, Cash and cash equivalents at June 30, 2005 includes approximately \$9.0 million of cash to be disbursed to Chimes vendors in accordance with the client payment terms. All this reduces company's available cash by almost a third. However, zero debt and the availability of a credit line eliminate the possibility of a cash starvation.

Cash Flows

Operating cash flow dominated the scenery during Q2FY05, bringing in \$7.3 million, driven mainly by an increase in accounts payable by \$5.4 million. Net cash used in investing activities was \$2.8 million, consisting primarily of \$2.4 million Deferred merger costs, which should be expensed during Q3FY05 due to the merger failure. Cash flow from financing activities was minuscule at \$179 thousand, resulting from stock option exercises and employee stock purchase plans.

STOCK PRICE EVOLUTION – 1 year



Alexandru Voizian is a Senior Analyst with Spelman Research. He joined the company in 2003 and has been covering the Technology, Healthcare and Services sectors. Prior to joining the Company, Mr. Voizian held economist positions at two commercial banks. Mr. Voizian earned his bachelor's degree in finance from the Academy of Economic Studies of Moldova in 2000. Mr. Voizian passed Level 1 exam of the CFA program and is currently registered for the Level 2 CFA exam.

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