

December 20, 2005

COMPUTER HORIZONS CORP.

Nasdaq: CHRZ

Rating: Speculative Buy

Price Target: \$4.7

Financial Summary		US\$ mn	2004A	2005E	2006E
52-Week Range	\$2.62/\$4.56	Net revenues	262.5	273.3	293.1
Recent Price (12/19/05)	\$4.20	Operating income	(27.1)	(18.5)	2.7
Market Cap	\$133 Mn	Net income (loss)	(25.2)	(19.5)	2.0
Current Shares Outstanding	31.6 Mn				
Avg. Daily Trading Volume (3m)	152,325	EPS, diluted	(\$0.82)	(\$0.62)	\$0.06
Tangible Book Value (per share)	\$3.00	PE	N/M	-6.8	67.9

Source: Yahoo! Finance, SEC filings, analyst estimates

Summary

We reiterate the Speculative Buy rating on CHRZ and assign a price target of \$4.7 per share, despite the recent turmoil, that the company has gone through. Even with the big losses it incurred, CHRZ remains poised to break even and the recent reorganization initiatives should restore the company's equilibrium and ultimately increase its profitability.

As we had expected, CHRZ suffered from the merger failure and the clash for the Board of Directors. With the old Board removed, CHRZ stands to pay millions of dollars in severance payments in addition to writing off significant amounts relating to the failed merger. Furthermore, the new management has initiated restructuring at its Commercial segment, laying off employees, which will cost almost \$1 million more to the company. All these extra costs are delaying the company's breakeven moment at least till the middle of 2006. Recent sluggishness in the Commercial segment also raises concerns, since this segment accounts for more than two thirds of the company's revenues.

President and CEO Dennis J. Conroy, refrained from providing any kind of outlook for the company, mentioning that the new management team is assessing the operations of the company and "its strategic alternatives". This leaves us only to speculate about the future of the company until management provides further guidance. Hence, our projections are based on a more cautious approach, especially following the merger failure and the subsequent imbalance inside the company.

RECENT EVENTS

Reorganization of the Commercial Services division

The new management team announced on December 1, that it intends to reorganize the Commercial Services Division in order to "clarify lines of accountability, sharpen the focus of service offerings, set performance standards and goals, and eliminate inefficiencies". Expected benefits are quantified by \$4-4.5 million in annual savings, mainly from SG&A personnel cost cuts. Management plans to execute this ambitious plan by reorganizing the entity into five geographic regions for Staffing sales, Recruiting and Operations, and two Solutions units. The execution of the plan is estimated to cost about \$900 thousand in personnel severance payments in Q4FY05.

New Contracts

On November 10, RGII Technologies, a subsidiary of CHRZ announced that it had won a \$15.7 million multi-year contract supporting the Technology Management, Integration and Standards (TMI&S) Directorate in support of the Military Health System (MHS) Chief Information Officer (CIO). RGII will be performing management support for Architecture and Technical Standards; Integration and Interoperability; Identity Protection and Management; Information Assurance; Web and database support, and a Management Control Program.

Management

On November 15, 2005, CHRZ hired Marci Braunstein to serve as the Company Controller effective November 29, 2005. The employment contract provides for a one year term with up to four months severance, with an annual base salary of \$130,000. Ms. Braunstein is also eligible to receive additional compensation in the form of a discretionary annual management bonus based upon the company's profitability.

FINANCIAL PERFORMANCE

The company's latest 10Q illustrated that the failed merger with the associated management war took its toll on the company: total revenue fell by 2.9% year-over-year. With management attention distracted from actually running the company, this is no wonder. Consequently, all the merger and restructuring costs sent the bottom line far below the zero mark. On the bright side, however, the gross margin improved slightly.

Income statement

\$'000, except per share data	Q3FY04	Q3FY05	YoY Change	Q2FY05	Q3FY05	QoQ Change
Revenue	69,397	67,417	-2.9%	69,066	67,417	-2%
Gross Profit	21,517	21,778	1.2%	21,303	21,778	2%
Operating Income	(818)	(7,436)	n/m	(54)	(7,436)	n/m
Net income	(460)	(7,338)	n/m	44	(7,338)	n/m
Diluted EPS, \$	(0.01)	(0.23)	n/m	0.00	(0.23)	n/m
Gross Margin	31.0%	32.3%	1.3 pp.	30.8%	32.3%	1.5 pp.
Operating Margin	-1.2%	-11.0%	-9.9 pp.	-0.1%	-11.0%	-11.0 pp.
Net Margin	-0.7%	-10.9%	-10.2 pp.	0.1%	-10.9%	-10.9 pp.

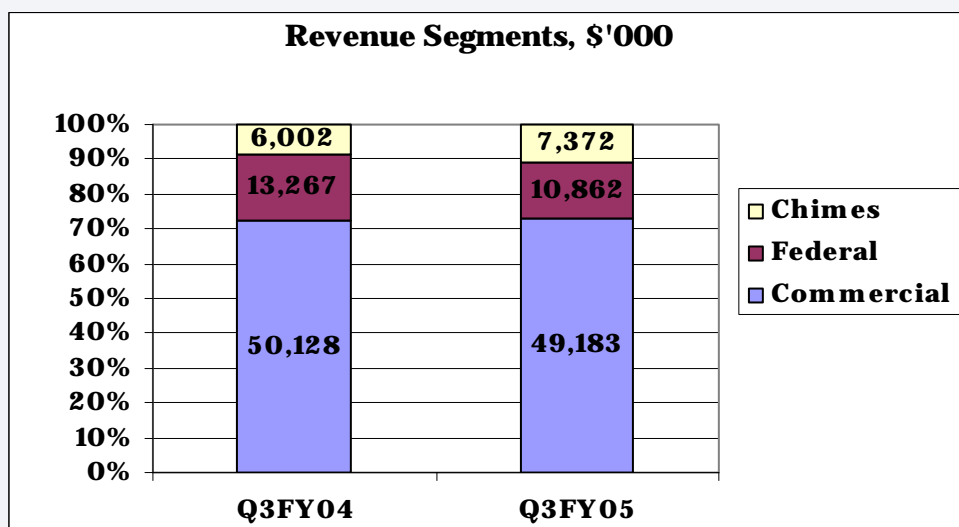
Source: company's SEC filings, analyst calculations

Of the \$7.4 million in operating losses during the last reported quarter, \$5.4 million relate to the Merger and proxy contest expenses, including the ANLY merger costs and proxy contest expenses pertaining to both the merger and the replacement of the company's Board of Directors, comprised primarily of legal and proxy solicitation costs. The company has not specified, whether the reported merger termination costs are final or there will be additional charges, such as expenses compensation to ANLY. Another factor contributing to the steep decline in the operating margin is the increase in SG&A expenses, which reached 34.1% of revenues in Q3FY05 versus 31.5% one year ago.

The bottom line is likely to remain depressed during Q4FY05 as well, as the company undergoes another restructuring initiative and the revenue is not likely to experience any significant recovery.

Revenue Mix

The Federal segment continued its shrinking trend, falling to 16.1% of total revenue in Q3FY05. The Chimes segment took over the revenue share lost by the Federal segment almost entirely, being the only segment which actually increased in dollar terms year-over-year.



Source: company's SEC filings

CHRZ explains the absolute year-over-year decrease in the Commercial Group revenues by a decrease in average consultant headcount of approximately 1% in combination with a 1% decline in average bill rates in comparison to the third quarter of 2004. The year-over-year decrease in the Federal segment revenues, in its turn, is attributed to the transition of restricted contracts, customer/agency budget cuts and delays in funding. The Chimes segment partially offset the decline in other segments' revenues, benefiting from both new and existing customers. The Chimes segment was also the one responsible for the general year-over-year gross margin improvement in Q3FY05, both because it is the highest-margin segment and because its gross margin experienced a slight increase

Balance sheet

CHRZ's balance sheet showed a healthy development during the quarter, with cash and equivalents increasing by 22% to \$43.8 million. It should be noted, however, that half of that amount (\$21.1 million) is restricted clients' cash to be distributed to Chimes vendors (\$9 million at June 30, 2005). Thus, the unrestricted cash decreased from approximately \$26.9 million to about \$22.7 million. However, debt is still zero, with a \$40 million credit facility available to the company, making the liquidity position of CHRZ pretty secure.

\$'000	Q2FY05	Q3FY05
Cash & Equiv.	35,854	43,777
Receivables	51,109	54,553
Net Working Capital	66,839	64,046
Total Assets	160,923	170,681
Debt	0	0
Shareholders' Equity	126,122	120,636

Source: company's SEC filings

Cash flows

Despite the fairly weak quarter in operating terms, operating cash flow brought in approximately \$7 million. Investing and financing activities were relatively insignificant (it must be noted, that due to the failure of the merger with ANLY, merger costs, previously included in the investing cash flows, have been removed and expensed).

VALUATION

We have valued CHRZ using DCF, P/S and EV/EBITDA methodologies. Using weighted average, we derived a price target of \$4.7 per share, or 11% above the current price.

Weight of methods

Method	Weight	Price target
DCF	50%	\$5.2
EV/EBITDA '06	20%	\$3.3
P/S '06	30%	\$4.7
Weighted price target		\$4.7

Source: analyst estimates

All figures in 000s USD, except per share data

DCF: MAJOR ASSUMPTIONS

Stock Price	\$4.20	Beta	1.09
Shares Outstanding, 000s	32,332	Risk Premium	4.0%
Mkt Cap, 000s	135,795	Risk Free Rate	4.5%
Book Value of Debt, \$000s	\$0.00	Small Cap Premium	1.0%
WACC	9.9%	Cost of Equity	9.9%
Terminal growth	4.0%		

Source: analyst estimates

000s USD	FYE05	FYE06	FYE07	FYE08	Terminal Value
EBIT	-18455	2746	9321	13173	
EBIT (1-T)	(18,455)	1,785	6,058	8,562	
Dep & Amort	4,997	5,247	5,510	5,785	
(-) Cap Ex	(2,287)	(2,401)	(2,401)	(2,401)	
(-) Changes in Non Cash WC	10,934	(2,500)	(2,500)	(2,500)	
Free Cash Flow	(4,810)	2,131	6,667	9,447	167,651

Source: analyst estimates

Discounted Cash Flow

DCF stream	8,900
DC terminal value	115,093
Total DC Enterprise Value	123,993
(Less) Interest Liabilities	(43,777)
Equity Value	167,770
Equity Value Per Share	\$5.19

Source: analyst estimates

P/S valuation

Revenues FY06E	293,099
Peers multiple	0.52

Equity value	151,307
Price target	\$4.68

Source: analyst estimates

EV/EBITDA valuation

EBITDA FY06E	7,032
Peers multiple	9.0
(Less) Interest Liabilities	(43,777)
Equity value	106,715
Price target	\$3.30

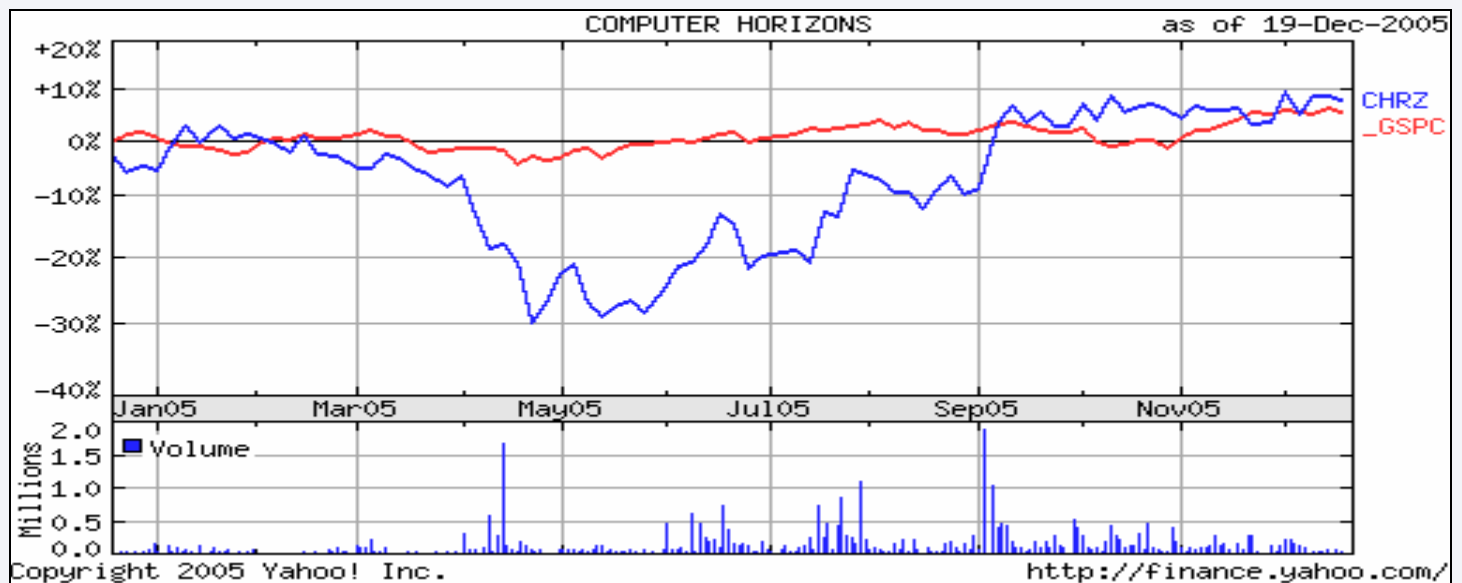
Source: analyst estimates

Peers' multiples

COMPANY NAME	TICKER SYMBOL	PRICE 12/19/05	MRKT CAP (MILS)	P/B	EV/ EBITDA	PSR ttm	PSR PS '06
COMPUTER HORIZONS	CHRZ	4.20	133	1.06	19.30	0.49	0.45
ACCENTURE	ACN	28.20	16,159	15.30	7.50	0.99	0.95
ELECTRONIC DATA SYS	EDS	23.40	12,204	1.60	4.60	0.60	0.61
ADECCO SA ADR	ADO	11.39	8,538	3.70	9.70	0.37	N/A
COMPUTER SCIENCES	CSC	49.10	9,084	1.40	4.90	0.62	0.61
MANPOWER	MAN	47.38	4,138	2.00	9.00	0.26	0.24
MPS GROUP	MPS	13.68	1,384	1.60	13.90	0.82	0.77
KELLY SERVICES 'A'	KELYA	26.07	933	1.40	9.90	0.18	0.16
KEANE	KEA	10.05	594	1.30	6.90	0.63	0.59
CIBER	CBR	6.60	413	1.10	8.70	0.43	0.43
CDI	CDI	28.74	570	2.10	22.40	0.52	0.44
COMPUTER TASK GROUP	CTG	3.95	82	1.40	13.60	0.30	0.26
COMFORCE	CFS	1.86	32	NM	8.90	0.06	N/A
Average				2.99	10.00	0.48	0.51
Median				1.60	8.95	0.47	0.52

Source: analyst estimates

STOCK PRICE EVOLUTION – 1 year



Source: Yahoo! Finance

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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