

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 June 30, 2004

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 No. 0-18492

TEAMSTAFF, INC.

(Exact name of registrant as specified in its charter)

NEW JERSEY
(State or other jurisdiction of
incorporation or organization)

22-1899798
(I.R.S. Employer
Identification No.)

300 ATRIUM DRIVE, SOMERSET, NEW JERSEY
(Address of principal executive offices)

08873
(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE (732) 748-1700

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 by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)

Yes No

15,714,229 shares of Common Stock, par value \$.001 per share, were outstanding as of June 30, 2004 and August 3, 2004.

TEAMSTAFF, INC. AND SUBSIDIARIES

FORM 10-Q
June 30, 2004

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TEAMSTAFF, INC. AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEETS
(AMOUNTS IN THOUSANDS)
(Page 1 of 2)**

	<u>JUNE 30, 2004</u> (unaudited)	<u>SEPTEMBER 30, 2003</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,503	\$ 4,329
Restricted cash	1,800	1,264
Accounts receivable, net of allowance for doubtful accounts of \$242 and \$142 at June 30, 2004 and September 30, 2003, respectively	3,569	4,926
Prepaid workers' compensation	4,310	3,645
Other current assets	<u>1,409</u>	<u>1,447</u>
Total current assets	<u>14,591</u>	<u>15,611</u>
EQUIPMENT AND IMPROVEMENTS:		
Equipment	2,795	2,628
Computer equipment	368	1,073
Computer software	1,120	1,060
Leasehold improvements	<u>224</u>	<u>146</u>
	4,507	4,907
Less accumulated depreciation and amortization	<u>(3,480)</u>	<u>(3,689)</u>
Equipment and improvements, net	<u>1,027</u>	<u>1,218</u>

DEFERRED TAX ASSET	17,387	14,875
TRADENAME	4,199	4,199
GOODWILL	1,710	1,710
OTHER ASSETS	348	555
ASSETS HELD FOR SALE	—	22,449
Total Assets	<u>\$ 39,262</u>	<u>\$ 60,617</u>

The accompanying notes to consolidated financial statements are an integral part of these consolidated balance sheets.

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TEAMSTAFF, INC. AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEETS
(AMOUNTS IN THOUSANDS)
(Page 2 of 2)**

	<u>JUNE 30, 2004 (unaudited)</u>	<u>SEPTEMBER 30, 2003</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 76	\$ 61
Accounts payable	773	669
Accrued payroll	807	2,856
Deferred tax liability	775	538
Accrued expenses and other current liabilities	2,611	3,181
Total current liabilities	<u>5,042</u>	<u>7,305</u>
LONG-TERM DEBT, net of current portion	84	94
ACCRUED PENSION LIABILITY	1,477	1,724
LIABILITIES HELD FOR SALE	1,224	16,384
Total liabilities	<u>7,827</u>	<u>25,507</u>
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Preferred stock, \$.10 par value; authorized 5,000 shares; 0 issued and outstanding	—	—
Common Stock, \$.001 par value; authorized 40,000 shares; issued 15,721 and 16,267 at June 30, 2004 and September 30, 2003, respectively; outstanding 15,714 and 15,714 at June 30, 2004 and September 30, 2003, respectively	16	16
Additional paid-in capital	62,963	65,256
Retained (deficit) earnings	(31,259)	(27,572)
Accumulated comprehensive losses	(261)	(273)
Treasury stock, 7 and 553 shares at cost at June 30, 2004 and September 30, 2003, respectively	(24)	(2,317)
Total shareholders' equity	<u>31,435</u>	<u>35,110</u>

The accompanying notes to consolidated financial statements
are an integral part of these consolidated balance sheets.

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TEAMSTAFF, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(Unaudited)

	For the three months ended	
	June 30,	
	2004	2003
REVENUES	\$ 9,642	\$ 14,654
DIRECT EXPENSES	7,333	11,753
Gross profit	<u>2,309</u>	<u>2,901</u>
OPERATING EXPENSES	2,956	4,352
DEPRECIATION AND AMORTIZATION	112	87
Loss from operations	<u>(759)</u>	<u>(1,538)</u>
OTHER INCOME (EXPENSE):		
Interest income	22	16
Interest expense	(13)	(11)
Other income	<u>53</u>	<u>120</u>
	<u>62</u>	<u>125</u>
Loss before tax	<u>(697)</u>	<u>(1,413)</u>
INCOME TAX BENEFIT	266	552
Loss from continuing operations	<u>(431)</u>	<u>(861)</u>
LOSS FROM DISCONTINUED OPERATIONS:		
Loss from operations, net of tax benefit of \$177 and \$171 for quarters ended June 30, 2004 and 2003, respectively	(287)	(1,403)
Loss from disposal, net of tax benefit of \$86 and \$0 for quarters ended June 30, 2004 and 2003, respectively	<u>(138)</u>	<u>—</u>
	<u>(425)</u>	<u>(1,403)</u>
Net loss	<u>(856)</u>	<u>(2,264)</u>
OTHER COMPREHENSIVE INCOME:		
Minimum pension liability adjustment, net of tax	<u>4</u>	<u>(70)</u>
COMPREHENSIVE LOSS	<u>\$ (852)</u>	<u>\$ (2,334)</u>
LOSS PER SHARE – BASIC AND DILUTED		
Loss from continuing operations	\$ (0.03)	\$ (0.05)
Loss from discontinued operations	<u>(0.02)</u>	<u>(0.09)</u>
Net loss	<u>\$ (0.05)</u>	<u>\$ (0.14)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	<u>15,714</u>	<u>15,684</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND EQUIVALENTS OUTSTANDING – DILUTED	<u>15,714</u>	<u>15,684</u>

The accompanying notes to consolidated financial statements
are an integral part of these consolidated statements.

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TEAMSTAFF, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(Unaudited)

	For the nine months ended	
	June 30,	
	2004	2003
REVENUES	\$ 28,179	\$ 49,489
DIRECT EXPENSES	21,717	39,902
Gross profit	6,462	9,587
OPERATING EXPENSES	8,915	11,695
DEPRECIATION AND AMORTIZATION	300	238
Loss from operations	(2,753)	(2,346)
OTHER INCOME (EXPENSE):		
Interest income	34	70
Interest expense	(71)	(181)
Other income	173	393
	136	282
Loss before tax	(2,617)	(2,064)
INCOME TAX BENEFIT	996	738
Loss from continuing operations	(1,621)	(1,326)
LOSS FROM DISCONTINUED OPERATIONS:		
Loss from operations, net of tax benefit of \$706 and \$3,081 for nine months ended June 30, 2004 and 2003, respectively	(1,145)	(26,810)
Loss from disposal, net of tax benefit of \$571 and \$0 for nine months ended June 30, 2004 and 2003, respectively	(921)	—
	(2,066)	(26,810)
Net loss	(3,687)	(28,136)
OTHER COMPREHENSIVE INCOME (EXPENSE):		
Minimum pension liability adjustment, net of tax	12	(133)
COMPREHENSIVE LOSS	\$ (3,675)	\$ (28,269)
LOSS PER SHARE – BASIC AND DILUTED		
Loss from continuing operations	\$ (0.10)	\$ (0.09)
Loss from discontinued operations	(0.13)	(1.70)
Net loss	\$ (0.23)	\$ (1.79)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING – BASIC	15,714	15,743
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND EQUIVALENTS OUTSTANDING – DILUTED	15,714	15,743

The accompanying notes to consolidated financial statements
are an integral part of these consolidated statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(AMOUNTS IN THOUSANDS)
(Unaudited)

	For the nine months ended June 30,	
	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss from continuing operations	\$ (1,621)	\$ (1,326)
Adjustments to reconcile net loss to net cash (used) by operating activities, net of acquired businesses:		
Deferred income taxes	(90)	(1,481)
Depreciation and amortization	300	238
Pension amortization	—	612
Provision for doubtful accounts	150	94
Changes in operating assets and liabilities, net of acquired businesses:		
(Increase) in restricted cash	(536)	(885)
Decrease in accounts receivable	1,207	1,249
(Increase) decrease in other current assets	(628)	1,298
(Increase) in other assets	(2,214)	(3,995)
(Decrease) in accounts payable, accrued payroll, accrued expenses and other current liabilities	(2,278)	(1,809)
(Decrease) increase in pension liability	(247)	430
Change in net assets held for sale & loss from discontinued operations	5,133	410
Net cash (used in) operating activities	(824)	(5,165)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of equipment, leasehold improvements and software	(19)	(549)
Earn out provision on prior acquisition	—	79
Net cash (used in) investing activities	(19)	(470)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on capital leases obligations	(45)	(39)
Repurchase of common shares	—	(782)
Proceeds from capital lease	50	—
Net comprehensive income (expense) on pension	12	(133)
Net cash provided by (used in) financing activities	17	(954)
Net (decrease) in cash and cash equivalents	(826)	(6,589)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4,329	12,455
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 3,503	\$ 5,866
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for-		
Interest	\$ 71	\$ 119
Income taxes	\$ 46	\$ 370

The accompanying notes to consolidated financial statements
are an integral part of these consolidated statements.

TEAMSTAFF, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2004
(Unaudited)

(1) ORGANIZATION AND BUSINESS:

TeamStaff, Inc., a New Jersey corporation, was founded in 1969 as a payroll service company and has evolved into a leading provider of outsourced business solutions focusing on human resource services to a wide variety of industries in 50 states. TeamStaff's corporate headquarters is in Somerset, New Jersey and it has offices located in Clearwater, Florida, Woburn, Massachusetts, and Alpharetta, Georgia. TeamStaff's wholly-owned subsidiaries include TeamStaff Rx, Inc., DSI Staff ConnXions-Northeast Inc., DSI Staff ConnXions-Southwest Inc., TeamStaff Solutions, Inc., TeamStaff I, Inc., TeamStaff II, Inc., TeamStaff III, Inc., TeamStaff IV, Inc., TeamStaff

V, Inc., TeamStaff VI, Inc., TeamStaff Insurance Services, Inc., TeamStaff VIII, Inc., Employer Support Services, Inc., TeamStaff IX, Inc., Digital Insurance Services, Inc., HR2, Inc., and BrightLane.com, Inc. When we use the term TeamStaff, sometimes we will mean TeamStaff and its subsidiaries. As a result of the recent sale of our PEO business as describe below, many of these subsidiaries are not actively operating.

TeamStaff provides a variety of employment related services through two business units: (1) Its TeamStaff Rx unit provides medical allied health professionals and nurses to doctors' offices and medical facilities throughout the United States on a temporary or permanent basis; and (2) the payroll services division provides customized payroll management and tax filing services to select industries, such as construction. We believe our medical staffing subsidiary is one of the top providers in the niche medical imaging field, placing temporary employees for over 275 clients. The payroll processing division processes payrolls for approximately 700 clients with more than 30,000 employees.

Effective November 17, 2003, TeamStaff sold certain of the assets of the subsidiaries through which it operated its professional employer organization ("PEO") business to Gevity HR, Inc. for the sum of \$9.5 million in cash, \$2.5 million of which had been placed in escrow. Under the terms of the asset sale, the escrowed payment was scheduled to be determined approximately 90 days from the November 17, 2003, closing, but was subject to downward adjustment based on any reduction in annualized administrative fees payable by the former TeamStaff PEO clients. Any such downward adjustment could be offset by annualized administrative fees of certain clients produced by former TeamStaff sales representatives during the 90-day period. The assets sold consisted primarily of client contracts, marketing agreements and internally developed software for use in reconciling certain benefit provider monthly invoices. As part of the transaction, Gevity HR, Inc. agreed, among other things, to hire certain former TeamStaff employees assigned to the PEO division and assume certain of TeamStaff's lease obligations. Further, TeamStaff agreed to a non-competition agreement which prohibits us from engaging in the PEO business for a period of five years. As a result of the transaction with Gevity, our internal corporate employee staff was reduced by approximately 117 persons, and our workforce staff was reduced by approximately 17,000 worksite employees.

On April 23, 2004, TeamStaff and Gevity agreed that TeamStaff's share of the \$2.5 million placed in escrow was \$2.25 million. That amount was released from escrow for TeamStaff's benefit. When added to the \$7.0 million previously paid by Gevity, the total purchase price paid was \$9.25 million. Concurrently, TeamStaff settled obligations to Gevity related to payroll for TeamStaff's internal employees under a co-employment arrangement of \$1.2 million, and settled obligations predominantly related to PEO client payments received by TeamStaff during the period following the sale, offset in part by invoices paid by TeamStaff on Gevity's behalf, totaling \$1.1 million. See Note 3 "Discontinued Operations."

Additionally, effective May 2, 2004, TeamStaff sold certain of the assets of TeamStaff Solutions, Inc., the subsidiary through which it operated its temporary technical staffing business, to Metro Tech Consulting Services, Inc. for the sum of \$65,000. See Note 3 "Discontinued Operations."

Basis of Presentation:

TeamStaff accounts for its revenues in accordance with EITF 99-19, *Reporting Revenues Gross as a Principal Versus Net as an Agent* and SAB 104, *Revenue Recognition*. TeamStaff recognizes all amounts billed to its temporary staffing customers as gross revenue because, among other things, TeamStaff is the primary obligor in the temporary staffing arrangement, TeamStaff has pricing latitude, TeamStaff selects temporary employees for a given assignment from a broad pool of individuals, TeamStaff is at risk for the payment of its direct costs, and TeamStaff assumes a significant amount of other risks and liabilities as an employer of its temporary employees, and therefore, is deemed to be a principal in regard to these services. TeamStaff also recognizes as gross revenue and as unbilled receivables, on an accrual basis, any such amounts that relate to services performed by temporary employees which have not yet been billed to the customer as of the end of the accounting period.

The Medical Staffing revenue is recognized as service is rendered. TeamStaff bills its clients based on an hourly rate. The hourly rate is intended to cover TeamStaff's direct labor costs of the temporary employees, plus an estimate to cover overhead expenses and a profit margin. Additionally, included in revenue related to Medical Staffing are commissions from permanent placements. Commissions from permanent placements result from the successful placement of a medical staffing employee to a customer's workforce as a permanent employee.

The Payroll Services revenue is recognized as service is rendered and consists primarily of administrative service fees charged to clients for the processing of paychecks as well as preparing quarterly and annual payroll related reports.

The consolidated financial statements included herein have been prepared by TeamStaff, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although TeamStaff believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in TeamStaff's latest annual report on Form 10-K. This financial information reflects, in the opinion of management, all adjustments necessary (consisting only of normal recurring adjustments) to present fairly the results for the interim periods. The results of operations for such interim periods are not necessarily indicative of the results for the full year.

The accompanying consolidated financial statements include the accounts of TeamStaff, Inc., and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

Certain prior year amounts have been reclassified to conform to current year presentation.

(2) SIGNIFICANT ACCOUNTING POLICIES:

Recently Adopted Accounting Standards:

In December 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits – an amendment of FASB Statements No. 87, 88, and 106" ("SFAS 132 (revised 2003)"), effective for fiscal years beginning after December 15, 2002, subject to certain exemptions. SFAS 132 (revised 2003) revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," Statement of Financial Accounting Standards No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." This Statement retains the disclosure requirements contained in

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Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" ("SFAS 132"), which it replaces. It requires additional disclosures to those in the original SFAS 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The required information should be provided separately for pension plans and for other postretirement benefit plans. The Company adopted SFAS 132 (revised 2003) as of January 1, 2004. The effect of the adoption of this statement was not material.

The Company recognizes revenue in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB 104"). Under SAB 104, revenue is recognized when there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the sales price is determinable, and collectibility is reasonably assured. Revenue typically is recognized as service has been rendered. Sales are recorded net of discounts, rebates, and returns.

Stock-Based Compensation:

At June 30, 2004, TeamStaff has two stock-based employee compensation plans, which are described more fully in TeamStaff's latest annual report on Form 10-K. TeamStaff accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. No stock-based employee compensation cost is reflected, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, as amended, to stock-based employee compensation.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2004	2003	2004	2003
	(Amounts in thousands, except per share data)			
Net loss, as reported	\$ (856)	\$ (2,264)	\$ (3,687)	\$ (28,136)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(70)	(152)	(190)	(408)
Pro forma net loss	<u>\$ (926)</u>	<u>\$ (2,416)</u>	<u>\$ (3,877)</u>	<u>\$ (28,544)</u>
Loss per share:				
Basic & diluted-as reported	<u>\$ (0.05)</u>	<u>\$ (0.14)</u>	<u>\$ (0.23)</u>	<u>\$ (1.79)</u>
Basic & diluted-pro forma	<u>\$ (0.06)</u>	<u>\$ (0.15)</u>	<u>\$ (0.25)</u>	<u>\$ (1.81)</u>

In accordance with Statement of Financial Accounting Standards No. 123, the fair value of option grants is estimated on the date of grant using the Black-Scholes option-pricing model for pro forma footnote purposes with the following assumptions; dividend yield of 0%, risk-free interest rate of 3.73% and 2.47% in fiscal year 2004 and 2003, respectively, expected option life of 4 years, and expected volatility of 68% and 73% in fiscal year 2004 and 2003, respectively.

Earnings Per Share:

Basic earnings per share ("Basic EPS") is calculated by dividing income available to common shareholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share ("Diluted EPS") is calculated by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period adjusted to reflect potentially dilutive securities.

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In accordance with SFAS 128, the following table reconciles basic shares outstanding to fully diluted shares outstanding:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2004	2003	2004	2003
	(Amounts in thousands)			
Weighted average number of common shares outstanding-basic	15,714	15,684	15,714	15,743
Incremental shares for assumed conversion of stock options/warrants	—	—	—	—
Weighted average number of common shares outstanding-diluted	15,714	15,684	15,714	15,743

Stock options and warrants outstanding at June 30, 2004 to purchase 1,315,797 shares of common stock and at June 30, 2003 to purchase 1,112,743 shares of common stock were not included in the computation of diluted earnings per share as they were antidilutive.

Income Taxes:

TeamStaff has recorded a \$17.4 million deferred tax asset at June 30, 2004 and \$14.9 million at September 30, 2003. This represents management's estimate of the income tax benefits to be realized upon utilization of its net operating losses and tax credits as well as temporary differences between the financial statement and tax basis of certain assets and liabilities, for which management believes utilization to be more likely than not. Management believes TeamStaff's operations can generate sufficient taxable income to realize this deferred tax asset as a result of historical profitability and its ability to generate operating income in the future.

Payroll Taxes:

TeamStaff has received notices from the IRS and state agencies claiming taxes, interest and penalties due related to payroll taxes predominantly from its former PEO operations. Management believes that these notices are predominantly the result of misapplication of payroll tax payments between its legal entities. If not resolved favorably, the Company may incur interest and penalties. Until the recent sale of certain assets as described elsewhere, TeamStaff operated through 17 subsidiaries, and management believes that the IRS and certain state agencies have not correctly identified payments made through certain of the different entities, therefore leading to the notices. To date, TeamStaff has been working with the IRS and various state agencies to resolve these discrepancies and has had certain interest and penalty claims abated. TeamStaff has retained the services of Ernst & Young LLP to assist it in resolving certain of these matters with the IRS. TeamStaff believes that after the IRS applies all the funds correctly, any significant interest and penalties will be abated; however, there can be no assurance that each of these federal and state matters will be resolved favorably.

Comprehensive Income (Loss):

TeamStaff has comprehensive losses resulting from its Supplemental Executive Retirement Plan (SERP) (See Note 5). When TeamStaff's SERP obligations were measured at June 30, 2004, the amount of the Projected Benefits Obligation (PBO) exceeded the recorded SERP liability. These changes resulted in a comprehensive income net of tax for the three months ended June 30, 2004 of \$4,000 and for the three months ended June 30, 2003, a comprehensive loss net of tax of \$70,000. For the nine months ended June 30, 2004, these changes resulted in a comprehensive income net of tax of \$12,000 and for the nine months ended June 30, 2003, a comprehensive loss net of tax of \$133,000. No other sources of comprehensive gains or losses occurred.

Workers' Compensation:

As discussed more fully below, TeamStaff's workers' compensation insurance program is provided by Zurich American Insurance Company. The Zurich program originally covered the period from March 22, 2002 through March 31, 2003, inclusive. On March 28, 2003, TeamStaff renewed its workers' compensation program with Zurich for the period from April 1, 2003, through March 31, 2004, inclusive. The renewal program contained a large deductible feature of \$0.5 million for each claim, with a maximum liability cap of the greater of 104.41% of manual premium or \$15.6 million. The premium for the program was paid monthly based upon estimated payroll for the year and is subject to a policy year-end audit. The renewal program was collateralized by a letter of credit inuring to the benefit of Zurich, and cash held in a trust account with a third party. A letter of credit for \$3.5 million was secured through Fleet, as part of TeamStaff's line of credit. However, effective March 31, 2004, Zurich agreed to a reduction in the amount of the letter of credit to \$1.8 million. As a result, on March 31, 2004, TeamStaff secured a new letter of credit in the amount of \$1.8 million with SunTrust Bank. Payments were made to the trust monthly based on projected claims for the year. Interest on all assets held in the trust is credited to TeamStaff. Payments for claims and claims expenses are made from the trust. Assets in the trust may be adjusted from time to time based on program experience. Claims handling services for the program are provided by GAB Robins, a third party administrator. On May 12, 2004, TeamStaff received \$963,000 in return premiums from Zurich. At June 30, 2004, TeamStaff has a prepaid current asset of \$4.3 million for the premiums and the prepayments made to the trust for both years of the Zurich plan.

In conjunction with the sale of its PEO assets to GevityHR, Inc., TeamStaff requested a pro rata cancellation of this policy effective as of November 17, 2003. TeamStaff entered into a new workers' compensation program with Zurich covering TeamStaff's temporary employees and, as of January 1, 2004, its corporate employees. The program is managed by Cedar Hill and claims handling services for the program are provided by GAB Robins. This program is a fully-insured, guaranteed cost program that contains no deductible or retention feature. This policy terminated April 1, 2004. Effective April 1, 2004, TeamStaff entered into a new workers' compensation

program with Zurich, covering the period from April 1, 2004 through March 31, 2005, with the same terms as the previous policy.

(3) DISCONTINUED OPERATIONS:

Effective November 17, 2003, TeamStaff sold certain of the assets of the subsidiaries through which it operated its professional employer organization ("PEO") business to Gevity HR, Inc. for the sum of \$9.5 million in cash, \$2.5 million of which had been placed in escrow.

On April 23, 2004, TeamStaff and Gevity agreed that TeamStaff's share of the \$2.5 million placed in escrow was \$2.25 million. That amount was released from escrow for TeamStaff's benefit. When added to the \$7.0 million previously paid by Gevity, the total purchase price paid was \$9.25 million. Concurrently, TeamStaff settled obligations to Gevity related to payroll for TeamStaff's internal employees under a co-employment arrangement of \$1.2 million, and settled obligations predominantly related to PEO client payments received by TeamStaff during the period following the sale, offset in part by invoices paid by TeamStaff on Gevity's behalf, totaling \$1.1 million. Additionally, effective May 2, 2004, TeamStaff sold certain of the assets of TeamStaff Solutions, Inc., the subsidiary through which it operated its temporary technical staffing business, to Metro Tech Consulting Services, Inc. for the sum of \$65,000.

Goodwill is assigned to specific reporting units and, in accordance with SFAS 142, is reviewed for possible impairment at least annually or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount may be greater than its fair value. As of the fiscal quarter ended December 31, 2002, TeamStaff carried a total of \$27.2 million in goodwill. During the fiscal quarter ended March 31, 2003, TeamStaff determined that the carrying amount of the PEO reporting segment exceeded its fair value, which was estimated based on the present value of expected future cash inflows and the market approach which compares TeamStaff to other comparable entities. The decision to test for impairment was based on a variety of factors, including, but not limited to, the overall downturn in the nation's economy, the relatively recent substantial decrease in

the number of TeamStaff PEO worksite employees, the performance of the Wachovia marketing relationship, the reduced valuations of individual PEOs by various market analysts and the associated market downgrade in the PEO industry generally. Accordingly, a goodwill impairment loss of \$20.4 million, as indicated by an independent outside valuation, was recognized in the PEO reporting unit for the fiscal quarter ended March 31, 2003. As a result of the sale of the PEO business, TeamStaff has written off the remaining goodwill related to the PEO business of \$5.4 million in the first fiscal quarter of 2004.

Intangible assets that are subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. Assets not subject to amortization are tested for impairment at least annually. As part of its acquisition of BrightLane, completed in August 2001, TeamStaff entered into a two-year, extendable marketing relationship with First Union Corporation (renamed Wachovia). The Wachovia relationship was intended to provide TeamStaff with the ability to market its PEO services to Wachovia's small business customers through Wachovia's network of small business bankers. The relationship did not produce the anticipated number of PEO clients or worksite employees. During the fiscal quarter ended March 31, 2003, TeamStaff determined that, based on estimated future cash flows, the carrying amount of the Wachovia marketing relationship, which was assigned to TeamStaff's PEO reporting segment, exceeded its fair value by \$5.7 million; accordingly, an impairment loss of that amount, as indicated by an independent outside valuation, was recognized and was included in impairment of intangible assets. TeamStaff later received written notice from Wachovia terminating the current agreement effective as of October 14, 2003. TeamStaff therefore wrote-off the full remaining value of the Wachovia relationship, \$1.2 million, during the third fiscal quarter 2003. The impairment of these intangible assets were included in discontinued operations in the appropriate periods.

For all periods presented, TeamStaff has accounted for the discontinued operation in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", within the consolidated financial statements and notes to consolidated financial statements included in this Form 10-Q filing.

The following chart details assets and liabilities held for sale:

	June 30, 2004	September 30, 2003
(amounts in thousands)		
ASSETS		
Cash	\$ —	\$ —
Net accounts receivable	—	14,191
Other current assets	—	353
Total current assets	<u>—</u>	<u>14,544</u>
Fixed assets	—	4,874
Accumulated depreciation	—	(2,547)
Net fixed assets	<u>—</u>	<u>2,327</u>
Goodwill	—	5,390
Intangible assets	—	10
Other assets	—	178
Total assets	<u>\$ —</u>	<u>\$ 22,449</u>
LIABILITIES		

Accounts payable	\$	—	\$	1,199
Accrued payroll		—		13,905
Accrued expenses and other current liabilities		1,224		859
Total current liabilities		<u>1,224</u>		<u>15,963</u>
Client security deposits		—		421
Total liabilities	\$	<u>1,224</u>	\$	<u>16,384</u>

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Net revenues for the PEO segment for the three months ended June 30, 2004 and 2003 were \$0 and \$21.0 million, respectively. Net revenues for the PEO segment for the nine months ended June 30, 2004 and 2003 were \$11.6 million and \$66.5 million, respectively.

TeamStaff's loss, net of tax, from discontinued operations is \$0.4 million for the third fiscal quarter of 2004 and \$2.1 million for the first nine months of fiscal year 2004. TeamStaff's loss, net of tax, from disposal is \$0.1 for the third fiscal quarter of 2004 and \$0.9 million for the first nine months of fiscal year 2004. The loss on disposal is based on the selling price of \$9.25 million, \$7.0 million at closing and \$2.25 million paid from the escrow account, offset by expenses including the writedown of goodwill and fixed assets, salary, severance and stay bonus payouts to affected employees, accruals for losses from lease obligations in offices no longer used by TeamStaff's continuing operations (offset by estimated sublease of unoccupied office space), investment banking fees and other expenses required to dispose of the PEO business.

In determining the loss from the sale of the PEO assets, TeamStaff incurred the following disposal costs:

	<u>Total Amount Accrued</u>	<u>Amount Accrued Current Quarter</u>
	(amounts in thousands)	
Disposal Costs		
Termination benefits	\$ 622	\$ 22
Lease obligations (net of estimated sublease income)	1,620	265
Fixed asset write-offs	2,028	—
Goodwill write-offs	5,390	—
Investment banking fees	271	—
All other	892	—
Total	<u>\$ 10,823</u>	<u>\$ 287</u>

The increase in expenses this quarter resulted from additional severance costs beyond our estimate at March 31, 2004 and changes to estimated lease expense and sublease income from offices no longer used by TeamStaff.

	<u>March 31, 2004 Balance</u>	<u>Expensed This Quarter</u>	<u>Paid This Quarter</u>	<u>June 30, 2004 Balance</u>
	(amounts in thousands)			
Liability Balances				
Accounts payable	\$ 1,090	\$ —	\$ (1,090)	\$ —
Accrued payroll	211	22	(233)	—
Accrued expenses and other current liabilities	1,170	265	(339)	1,224
Total	<u>\$ 2,471</u>	<u>\$ 287</u>	<u>\$ (1,662)</u>	<u>\$ 1,224</u>

(4) DEBT:

On April 9, 2002, TeamStaff entered into a revolving loan facility with Fleet National Bank ("Fleet"). The total outstanding loan amount could not exceed at any one time the lesser of \$7.0 million or the sum of 85% of qualified accounts receivable, less an amount reserved by Fleet to support direct debit processing exposure. The annual interest rate was either the Fleet prime rate or LIBOR, at the discretion of TeamStaff. The facility was collateralized by substantially all of the assets of TeamStaff, including its accounts receivable. The facility was subject to certain covenants including, but not limited to, interest rate coverage of 2.0 to 1.0, total liabilities to tangible net worth ratio of 2.0 to 1.0, and minimum working capital of \$10.0 million.

Effective March 21, 2003, the Company and Fleet agreed to a renewal of the revolving loan facility, which expired on March 31, 2004. The terms of the facility were substantially as described above, except that the total outstanding loan amount at any one time could not exceed the lesser of \$6.0 million or the sum of 85% of the qualified accounts receivable less an amount reserved by Fleet.

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TeamStaff used this loan agreement as collateral for a letter of credit in the amount of \$3.5 million issued with respect to TeamStaff's workers' compensation program with Zurich effective April 1, 2003 described above. In

connection with the sale of certain PEO assets to Gevity HR, Inc., TeamStaff was required to obtain the consent of Fleet to the transaction. As part of its agreement to the sale of PEO assets (which served as collateral for the loan) Fleet required that TeamStaff provide substitution collateral in the form of a \$3.5 million cash deposit at Fleet. The revolving loan facility and the letter of credit expired on March 31, 2004. As a result, the \$3.5 million cash deposit was released by Fleet.

Effective March 31, 2004, Zurich reduced the amount of the letter of credit collateralization requirement for the workers' compensation program to \$1.8 million. TeamStaff has secured a letter of credit in that amount from SunTrust Bank. The letter of credit is collateralized by a certificate of deposit for \$1.8 million deposited at SunTrust.

(5) SUPPLEMENTAL RETIREMENT PLAN:

Effective October 1, 2000, TeamStaff adopted a non-qualified Supplemental Retirement Plan (SERP) covering certain TeamStaff corporate officers. TeamStaff's former President and Chief Executive Officer and its former Chief Financial Officer were the only SERP participants. SERP participants also were provided with a split dollar life insurance policy, insuring the life of the participant. Each participant collaterally assigned his policy to TeamStaff to secure repayment of policy premiums. In connection with the change in their employment status, TeamStaff engaged in negotiations with its former President and Chief Executive Officer and the former Chief Financial Officer regarding the payment of certain severance benefits and the satisfaction of TeamStaff's obligations to each of them under the SERP and the split dollar life insurance arrangements. On December 31, 2003, TeamStaff executed an agreement with its former President and Chief Executive Officer pursuant to which TeamStaff agreed to, among other things, release the collateral assignment of the split dollar life insurance policy as of December 31, 2003 and to accelerate the payment of certain agreed upon payments under the SERP in complete satisfaction of TeamStaff's obligations under the SERP. TeamStaff entered into a similar agreement with its former Chief Financial Officer effective as of December 30, 2003. That agreement also provided for the payment of severance and other benefits over time in satisfaction of TeamStaff's obligations to its former Chief Financial Officer under his severance agreement effective May 22, 2002. The effect of these settlements with the former President and Chief Executive Officer and former Chief Financial Officer in fiscal year 2004 will be \$0.4 million of additional expense related to the SERP. Cash payments of \$1.5 million have been made to the former President and Chief Executive Officer and the former Chief Financial Officer in the first six months of fiscal year 2004.

Components of Net Periodic Benefit Cost:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2004	2003	2004	2003
	(amounts in thousands)			
Service cost	\$ —	\$ —	\$ —	\$ 17
Interest cost	39	23	80	68
Amortization of prior service cost	—	—	—	30
Amortization of net (gain)/loss	27	3	57	11
Curtailement charges	—	445	—	699
Settlement charges	88	—	276	—
Total pension cost	<u>\$ 154</u>	<u>\$ 471</u>	<u>\$ 413</u>	<u>\$ 825</u>

Employer Contributions to Pension Plan:

For the nine months ended June 30, 2004, TeamStaff has contributed \$296,000. TeamStaff anticipates contributing an additional \$133,000 in fiscal 2004 for a total of \$429,000.

(6) STOCK OPTIONS:

During the quarter ended June 30, 2004, TeamStaff granted 150,000 options at an average price of \$2.30, 93,740 options expired or were cancelled unexercised, no warrants expired unexercised, and no options were exercised. During the nine months ended June 30, 2004, TeamStaff granted 200,000 options at an average price of \$2.24 per share, 319,675 options expired or were cancelled unexercised, 21,428 warrants expired unexercised, and no options were exercised.

During the quarter ended June 30, 2003, TeamStaff granted 400,000 options at an average price of \$2.42 per share, 5,427 options expired or were cancelled unexercised, and no options were exercised. During the nine months ended June 30, 2003, TeamStaff granted 483,000 options at an average price of \$2.58 per share, 73,558 options expired or were cancelled unexercised, and no options were exercised.

(7) SEGMENT REPORTING:

As a part of continuing operations, TeamStaff operates two different lines of business: medical staffing and payroll services.

TeamStaff currently provides temporary and permanent staffing for allied healthcare professionals and nurses with hospitals, clinics and therapy centers. Medical staffing enables clients to attain management and productivity goals by matching highly trained professionals and technical personnel to specific project requirements.

Through its Payroll Services business segment, TeamStaff provides basic payroll services to its clients, approximately 75% of which are in the construction industry. Services provided include the preparation of payroll checks, filing of payroll taxes, government reports, W-2's, remote processing directly to the client's offices and certified payrolls.

All corporate expenses, interest expense, as well as depreciation on corporate assets and miscellaneous charges, are reflected in a separate unit called Corporate.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. TeamStaff evaluates the performance of its business lines based on pre-tax income.

The following table represents the financial results for each of TeamStaff's segments:

	Three months ended June 30,		Nine months ended June 30,	
	2004	2003	2004	2003
(In thousands)				
Medical Staffing:				
Revenues:	\$ 8,578	\$ 13,565	\$ 24,815	\$ 45,842
Income from operations before income taxes:	\$ 456	\$ 1,108	\$ 827	\$ 3,424
Payroll Services:				
Revenues:	\$ 1,064	\$ 1,089	\$ 3,364	\$ 3,647
Income from operations before income taxes:	\$ 371	\$ 323	\$ 1,331	\$ 1,228
Corporate:				
Revenues:	\$ —	\$ —	\$ —	\$ —
Loss from operations before income taxes:	(\$1,524)	(\$2,844)	(\$4,775)	(\$6,716)
Consolidated:				
Revenues:	\$ 9,642	\$ 14,654	\$ 28,179	\$ 49,489
Loss from operations before income taxes:	(\$697)	(\$1,413)	(\$2,617)	(\$2,064)

TeamStaff has no revenue derived from outside the United States.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking and Cautionary Statements

Certain statements contained herein constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "1995 Reform Act"). TeamStaff, Inc. desires to avail itself of certain "safe harbor" provisions of the 1995 Reform Act and is therefore including this special note to enable TeamStaff to do so. Forward-looking statements included in this report involve known and unknown risks, uncertainties, and other factors which could cause TeamStaff's actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Such future results are management's best estimates based upon current conditions and the most recent results of operations. These risks include, but are not limited to, risks associated with risks undertaken in connection with acquisitions, risks from potential workers' compensation claims and required payments, risks from employer/employee suits such as discrimination or wrongful termination, risks associated with payroll and employee related taxes which may require unanticipated payments by TeamStaff, liabilities associated with TeamStaff's status under certain federal and state employment laws as a co-employer, effects of competition, TeamStaff's ability to implement its internet based business and technological changes and dependence upon key personnel. These and other risks are stated in detail in our Report on Form 10-K for the fiscal year ended September 30, 2003 and other reports and filings made by TeamStaff.

Critical Accounting Policies and Estimates

TeamStaff believes its significant critical accounting policies have not changed since fiscal year end September 30, 2003. See Note 2 of TeamStaff's 2003 annual report on Form 10-K as well as "Critical Accounting Policies" contained therein for a detailed discussion on the application of these and other accounting policies.

Revenue Recognition

TeamStaff accounts for its revenues in accordance with EITF 99-19, *Reporting Revenues Gross as a Principal Versus Net as an Agent* and SAB 104, *Revenue Recognition*. TeamStaff recognizes all amounts billed to its temporary staffing customers as gross revenue because, among other things, TeamStaff is the primary obligor in the temporary staffing arrangement, TeamStaff has pricing latitude, TeamStaff selects temporary employees for a given assignment from a broad pool of individuals, TeamStaff is at risk for the payment of its direct costs, and TeamStaff assumes a significant amount of other risks and liabilities as an employer of its temporary employees, and therefore, is deemed to be a principal in regard to these services. TeamStaff also recognizes as gross revenue and as unbilled receivables, on an accrual basis, any such amounts that relate to services performed by temporary employees which have not yet been billed to the customer as of the end of the accounting period.

The Medical Staffing revenue is recognized as service is rendered. TeamStaff bills its clients based on an hourly rate. The hourly rate is intended to cover TeamStaff's direct labor costs of the temporary employees, plus an estimate to cover overhead expenses and a profit margin. Additionally, included in revenue related to medical staffing are commissions from permanent placements. Commissions from permanent placements result from the successful placement of a medical staffing employee to a customer's workforce as a permanent employee.

The Payroll services revenue is recognized as service is rendered and consists primarily of administrative service fees charged to clients for the processing of paychecks as well as preparing quarterly and annual payroll related reports.

Workers' Compensation

TeamStaff's current workers' compensation insurance provider is Zurich American Insurance Company. The program is managed by Cedar Hill Insurance Agency, Inc., whose duties include underwriting analysis, loss control services, and other program management services.

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The Zurich program originally covered the period from March 22, 2002 through March 31, 2003, inclusive. On March 28, 2003, TeamStaff renewed its workers' compensation program with Zurich for the period from April 1, 2003, through March 31, 2004, inclusive. (See Note 3 to the consolidated financial statements) The renewal program contained a large deductible feature of \$0.5 million for each claim, with a maximum liability cap of the greater of 104.41% of manual premium or \$15.6 million. The premium for the program was paid monthly based upon estimated payroll for the year and is subject to a policy year-end audit. The renewal program was collateralized by a letter of credit inuring to the benefit of Zurich, and cash held in a trust account with a third party. A letter of credit for \$3.5 million was secured through Fleet, as part of TeamStaff's line of credit. However, effective March 31, 2004, Zurich agreed to a reduction in the amount of the letter of credit to \$1.8 million. As a result, on March 31, 2004, TeamStaff secured a new letter of credit in the amount of \$1.8 million with SunTrust Bank. Payments were made to the trust monthly based on projected claims for the year. Interest on all assets held in the trust is credited to TeamStaff. Payments for claims and claims expenses are made from the trust. Assets in the trust may be adjusted from time to time based on program experience. Claims handling services for the program are provided by GAB Robins, a third party administrator. On May 12, 2004, TeamStaff received \$1.0 million in return premiums from Zurich. At June 30, 2004, TeamStaff has a prepaid current asset of \$4.3 million for the premiums and the prepayments made to the trust for both years of the Zurich plan.

In conjunction with the sale of its PEO assets to GevityHR, Inc., TeamStaff requested a pro rata cancellation of this policy effective as of November 17, 2003. TeamStaff entered into a new workers' compensation program with Zurich covering TeamStaff's temporary employees and, as of January 1, 2004, its corporate employees. The program is managed by Cedar Hill and claims handling services for the program are provided by GAB Robins. This program is a fully-insured, guaranteed cost program that contains no deductible or retention feature. This policy terminated April 1, 2004. Effective April 1, 2004, TeamStaff entered into a new workers' compensation program with Zurich, covering the period from April 1, 2004 through March 31, 2005, with the same terms as the previous policy.

As of June 30, 2004, the adequacy of the workers' compensation reserves was determined, in management's opinion, to be reasonable. In determining our reserves we rely in part upon information regarding loss data received from our workers' compensation insurance carriers which may include loss data for claims incurred during prior policy periods. As disclosed in our Form 10-K for the fiscal year ended September 30, 2003, TeamStaff has encountered difficulties in receiving timely reporting of claims from CNA for the workers' compensation programs covering January 22, 2001, through March 22, 2001. As previously disclosed, TeamStaff is disputing certain amounts that CNA claims is due as part those programs and filed a complaint with the New Jersey Division of Insurance, which referred the matter to the New Jersey Compensation Rating and Inspection Bureau. Although the New Jersey Compensation Rating and Inspection Bureau investigated the complaint and proposed a fine against CNA as well as a refund of \$0.2 million in policy issuance costs to TeamStaff, the matter remains unresolved between the parties. In the future, similar problems from our insurance carriers may result in adjustments to our reserves. In addition, these reserves are for claims that have not been sufficiently developed due to their relatively young age, and such variables as timing of payments and investment returns thereon are uncertain or unknown, actual results may vary from current estimates. TeamStaff will continue to monitor the development of these reserves, the actual payments made against the claims incurred, the timing of these payments, the interest accumulated in TeamStaff's prepayments and adjust the reserves as deemed appropriate.

Deferred Taxes

TeamStaff accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reflected on the balance sheet when it is determined that it is more likely than not that the asset will be realized.

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Results of Continuing Operations

TeamStaff's revenues for the three months ended June 30, 2004 and 2003 were \$9.6 million and \$14.7 million respectively, which represents a decrease of \$5.1 million or 34% from third fiscal quarter 2003 to third fiscal quarter 2004. The decline is attributable, in part, to the decrease in demand for temporary medical staffing workers. We believe hospitals continue to focus on cost efficiencies by placing greater reliance on existing full time staff. This, in turn, has led to less demand for temporary health care professionals. Longer term, we believe the demand for temporary medical personnel will increase, driven, in part, by an aging population and an improving economy. We also believe demand will increase as more states introduce legislation for mandatory minimum nurse to patient ratios and overtime limitations. Additionally, we continue to substantially expand our sales and marketing efforts in order to increase our contact with current and prospective clients. TeamStaff's revenues for the nine months ended June 30, 2004 and 2003 were \$28.2 million and \$49.5 million respectively, which represents a decrease of \$21.3 million or 43% from 2003 to 2004. The decline is attributable to the same reasons as stated above for the third quarter.

Direct expenses were \$7.3 million for the three months ended June 30, 2004 and \$11.8 million for the comparable quarter last year, representing a decrease of \$4.5 million or 38%. For the nine months ended June 30 2004 and 2003, direct expenses were \$21.7 million and \$39.9 million, respectively, representing a decrease of \$18.2 million or 46%. These decreases are a direct result of the lower revenues.

Gross profits were \$2.3 million and \$2.9 million for the quarters ended June 30, 2004 and 2003, respectively, representing a decrease of \$0.6 million or 20%. This decrease is attributed to the reduction in our Medical Staffing business as discussed above. Gross profits, as a percentage of revenue, were 24% and 20% for the quarters ended June 30, 2004 and 2003, respectively due to improved margins in the medical staffing division. For the nine months ended June 30, 2004 and 2003, gross profits were \$6.5 million and \$9.6 million respectively, representing a decrease of \$3.1 million or 33%. Gross profits as a percent of revenue were 23% and 19% for the nine months ended June 30, 2004 and 2003, respectively, again due to improved margins in the medical staffing division and the higher gross margin Payroll Services division, which represented 33% of total gross profit for the first nine months of fiscal 2004 vs. 24% in the first nine months of fiscal 2003, increasing TeamStaff's total gross margin percentage.

Operating expenses for the quarters ended June 30, 2004 and 2003 were \$3.0 million and \$4.4 million, respectively, representing a decrease of \$1.4 million or 32%. Operating expenses as a percentage of revenue were 31% and 30% for the three months ended June 30, 2004 and 2003, respectively, as revenue declined at a higher rate than operating expenses. This decrease resulted from lower SERP expenses and the absence of severance costs related to TeamStaff's former Chief Executive Officer and Chief Financial Officer and lower corporate expenses. For the nine months ended June 30, 2004 and 2003, operating expenses were \$8.9 million and \$11.7 million, respectively, representing a decrease of \$2.8 million or 24%, as a result of lower SERP expenses and the absence of severance costs related to TeamStaff's former Chief Executive Officer and Chief Financial Officer, lower corporate expenses, as well as reduced expenses in the Medical Staffing business. Operating expenses as a percentage of revenue were 32% and 24% for the nine months ended June 30, 2004 and 2003, respectively, as revenue declined at a higher rate than operating expenses. Operating expenses for the first nine months of 2004 were lower in each reporting segment than the first nine months of 2003. Additionally, while our Medical Staffing division has reduced overall operating expenses, we are increasing our product development, sales and marketing efforts in that division, which has partially offset reductions in general expenses.

Depreciation and amortization for the quarters ended June 30, 2004 and 2003 were \$0.1 million. Depreciation and amortization for the nine months ended June 30, 2004 and 2003 were \$0.3 and \$0.2 million, respectively.

Income tax benefit for the quarter ended June 30, 2004 and 2003 were \$0.3 million and \$0.6 million, respectively. These tax benefits are a result of losses from operations. Income tax benefit for the nine

months ended June 30, 2004 was \$1.0 million versus \$0.7 million for the nine months ended June 30, 2003. Again, these tax benefits are a result of losses from operations.

Loss from continuing operations for the quarter ended June 30, 2004 was \$0.4 million or \$(0.03) per fully diluted share, as compared to \$0.9 million or \$(0.05) per fully diluted share for the same period last year. This decreased loss is due to the lower SERP expenses, the absence of severance cost related to TeamStaff's former Chief Executive Officer and Chief Financial Officer, lower corporate expenses partially offset by the lower revenues in TeamStaff's Medical Staffing division. Loss from continuing operations for the nine months ended June 30, 2004 was \$1.6 million or \$(0.10) per fully diluted share, as compared to \$1.3 million or \$(0.09) per fully diluted share for the same period last year. This increased loss is due to lower revenues in our Medical Staffing division, offset partially by decreased cost related to TeamStaff's former Chief Executive Officer and Chief Financial Officer

Losses from discontinued operations, net of tax, for the quarters ended June 30, 2004 and 2003 were \$0.4 million and \$1.4 million, respectively. The loss in 2003 resulted primarily from the write-down of intangible assets from the PEO business. Losses from discontinued operations, net of tax, for the nine months ended June 30, 2004 and 2003 were \$2.1 million and \$26.8 million, respectively. The loss in 2003 resulted primarily from the write-down of goodwill and intangible assets from the PEO business. Loss from operations from the discontinued business unit, net of tax, for the nine months ended June 30, 2004 and 2003 were \$1.1 million and \$26.8 million respectively. TeamStaff generated revenue from the PEO business for only six weeks in the first nine months of 2004 while certain costs associated with the operation of that business unit continued for the full nine months. The loss in 2003 resulted primarily from the write-down of goodwill and intangible assets from the PEO business. Losses on disposal, net of tax, are \$0.9 million for the nine months ended June 30, 2004. The loss is based on the selling price of \$9.25 million, offset by expenses including the writedown of goodwill and fixed assets, salary, severance and stay bonus payouts to affected employees, accruals for losses from lease obligations in offices no longer used by TeamStaff's continuing operations offset by estimated sublease of unoccupied office space, investment banking fees and other expenses required to dispose of the PEO business.

Net loss for the quarter ended June 30, 2004 was \$0.9 million or \$(0.05) per fully diluted share, as compared to \$2.3 million or \$(0.14) per fully diluted share for the same period last year. Net loss for the nine months ended June 30, 2004 was \$3.7 million or \$(0.23) per fully diluted share, as compared to \$28.1 million or \$(1.79) per fully diluted share for the same period last year. The losses for fiscal year 2004 are the result of the decline in Medical Staffing revenues described above and the loss from discontinued operations. For fiscal year 2003, the losses are primarily from the writedowns of goodwill and intangible assets from our discontinued PEO business and SERP and severance costs related to TeamStaff's former Chief Executive Officer and Chief Financial Officer.

Liquidity and Capital Resources

Net cash used in operating activities in the first nine months of fiscal 2004 were \$0.8 million compared to \$5.2 million used in the same period of fiscal 2003. As part of the sale of the PEO business, TeamStaff received \$9.25 million in cash. Use of cash during the first nine months of 2004 included increased other current assets related to workers' compensation payments, increased other assets related to increases in TeamStaff's deferred tax asset, additional cash classified as restricted cash related to our letter of credit provided by SunTrust in connection with our Zurich workers' compensation program, reduction in severance obligations to TeamStaff's former CEO and CFO, and losses from continuing and discontinued operations.

Cash used in investing activities was virtually unchanged during the first nine months of fiscal year 2004 as opposed to \$0.5 million in the first nine months of fiscal year 2003.

Cash used in financing activities was virtually unchanged during the first nine months of fiscal year 2004 as opposed to \$1.0 million in the first nine months of fiscal year 2003. Last year's spending was primarily for the repurchase of 251,214 shares of TeamStaff stock.

As of June 30, 2004, TeamStaff had unrestricted cash and cash equivalents of \$3.5 million and net accounts receivable of \$3.6 million.

As of June 30, 2004, TeamStaff had working capital of \$9.5 million.

Management of TeamStaff believes that its existing cash and funds generated by operations will be sufficient to support cash needs for at least the next twelve months.

Effects of Inflation

Inflation and changing prices have not had a material effect on TeamStaff's net revenues and results of operations in the last three fiscal years, as TeamStaff has been able to modify its prices and cost structure to respond to inflation and changing prices.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

TeamStaff does not undertake trading practices in securities or other financial instruments and therefore does not have any material exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk or other similar risks, which might otherwise result from such practices. TeamStaff has no material interest rate risk, except with respect to our workers' compensation programs, and is not materially subject to fluctuations in foreign exchange rates, commodity prices or other market rates or prices from market sensitive instruments. In connection with TeamStaff's workers' compensation programs, prepayments of future claims are deposited into trust funds for possible future payments of these claims in accordance with the policies. The interest income resulting from these prepayments is for the benefit of TeamStaff, and is used to offset workers' compensation expense. If interest rates in these periods' decreases, TeamStaff's workers' compensation expense would increase because TeamStaff would be entitled to less interest income on the deposited funds.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures:

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c)) as of the end of the quarterly period (Evaluation Date) covered by this report on Form 10-Q. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of the date of their evaluation, our disclosure controls and procedures are effective to ensure that all material information required to be filed in this Quarterly Report on Form 10-Q has been made known to them.

Changes in Internal Controls:

There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date set forth above.

Part II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

TeamStaff's subsidiary, BrightLane, is party to a suit brought by one of its former shareholders (*Atomic Fusion, Inc. v. BrightLane.com, Inc. Civil Action No ONS02246OE, Fulton County State Court, Georgia*). The plaintiff seeks damages for alleged unpaid contractual services provided to BrightLane, alleging that the shares (both in number and value) of BrightLane stock provided to the plaintiff in payment of services were inadequate to pay

for the alleged agreed upon value of services. TeamStaff and BrightLane intend to defend themselves vigorously in this matter and believes that they have meritorious and valid defenses to plaintiff's claims. In addition, the former shareholders of BrightLane have placed approximately 158,000 shares in escrow to provide indemnification for any claims made by TeamStaff under the acquisition agreement, subject to a \$0.3 million threshold. Some or all of these shares may be canceled in an amount equal to the amount of any claim or expense in excess of the threshold. Under the terms of the agreements between TeamStaff and BrightLane, the

value of the shares held in escrow is \$8.10/share. It is possible that an award in favor of Atomic Fusion would result in monetary damages against TeamStaff, which could not be recovered under the indemnification provisions because cancellation of the shares in escrow is the sole method of satisfying these indemnification obligations. On November 20, 2003, the Fulton County Superior Court (to which the action was transferred) awarded summary judgment in BrightLane's favor on all counts of Atomic Fusion's complaint except for a breach of contract claim. Atomic Fusion has since amended its complaint in the matter to seek, among other things, punitive damages and attorneys' fees. A trial on this matter was scheduled to commence on May 10, 2004, however it was rescheduled to August 16, 2004.

As a commercial enterprise and employer and with respect to its employment-related businesses in particular, TeamStaff is engaged in litigation from time to time during the ordinary course of business in connection with employment-relations issues, medical professional liability, workers' compensation and other matters. Generally, TeamStaff is entitled to indemnification or repayment from its former PEO clients for claims brought by worksite employees related to their employment. However, there can be no assurance that the client employer will have funds or insurance in amounts to cover any damages or awards, and as co-employer, TeamStaff may be subject to liability. Additionally, although TeamStaff maintains policies of liability insurance that it believes are adequate considering the risks of its business, there can be no assurance that all claims against TeamStaff will be covered under those policies or the limits of coverage under those policies will adequately protect TeamStaff in the event of an adverse judgment.

TeamStaff is engaged in no other litigation, the effect of which would be anticipated to have a material adverse impact on TeamStaff's financial conditions or results of operations.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

The following reports were filed during the quarter ended June 30, 2004.

<u>Date of Report</u>	<u>Item Reported</u>
April 26, 2004	Item 5 Other Events/ Item 7 Financial Statements and Exhibits (in connection with TeamStaff's final settlement with Gevity HR, Inc and a reduction in workers' compensation letter of credit.)
May 5, 2004	Item 7 Financial Statements and Exhibits/ Item 12 Results of Operations and Financial Condition (in connection with TeamStaff's earnings release for the fiscal quarter ended March 30, 2003)

May 14, 2004	Item 5 Other Events/ Item 7 Financial Statements and Exhibits (in connection with TeamStaff's strategic alliance with Professional Placement Resources d/b/a PPR Travel.)
May 28, 2004	Item 7 Financial Statements and Exhibits/ Item 9 Regulation FD Disclosure.
June 9, 2004	Item 7 Financial Statements and Exhibits/ Item 9 Regulation FD Disclosure.

SIGNATURES

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

TEAMSTAFF, INC.
(Registrant)

/s/ T. Kent Smith

T. Kent Smith
President and Chief Executive Officer

/s/ Rick Filippelli

Rick Filippelli
Vice President, Finance and Chief Financial Officer

Date: August 3, 2004

EXHIBIT 31.1

CERTIFICATIONS

I, T. Kent Smith, certify that:

1. I have reviewed this quarterly report on Form 10-Q of TeamStaff, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officers 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)) and internal control over financial reporting for the registrant and have:
 - a) 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;
 - b) [RESERVED]
 - c) 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
 - d) 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 materially 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):
 - a) 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
 - b) 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: August 3, 2004

/s/ T. Kent Smith
T. Kent Smith
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Rick J. Filippelli, certify that:

1. I have reviewed this quarterly report on Form 10-Q of TeamStaff, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officers 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)) and internal control over financial reporting for the registrant and have:
 - a) 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;
 - b) [RESERVED]
 - c) 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
 - d) 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 materially 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):
 - a) 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
 - b) 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: August 3, 2004

/s/ Rick J. Filippelli
Rick J. Filippelli
Vice President, Finance and Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of TeamStaff, Inc (the Company) on Form 10-Q for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, being, T. Kent Smith, Chief Executive Officer of the Company, and Rick J. Filippelli, Chief Financial Officer of the Company, respectfully, certify, pursuant to 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Dated: August 3, 2004

/s/ T. Kent Smith
Chief Executive Officer

/s/ Rick J. Filippelli
Chief Financial Officer
