

CROSS COUNTRY HEALTHCARE INC  
Form 10-K  
March 18, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-33169  
Cross Country Healthcare, Inc.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or  
organization)

13-4066229  
(I.R.S. Employer Identification No.)

6551 Park of Commerce Boulevard, N.W.  
Boca Raton, Florida 33487  
(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (561) 998-2232

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.0001 per share	The NASDAQ Stock Market

Securities registered pursuant to Section 12(g) of the act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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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 has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act: Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of Common Stock on June 29, 2012 of \$4.37 as reported on the NASDAQ National Market, was \$131,163,868. This calculation does not reflect a determination that persons are affiliated for any other purpose.

As of February 28, 2013, 30,902,314 shares of Common Stock, \$0.0001 par value per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement, for the 2012 Annual Meeting of Stockholders, which statement will be filed pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Report, are incorporated by reference into Part III hereof.

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All references to “we,” “us,” “our,” or “Cross Country” in this Report on Form 10-K means Cross Country Healthcare, Inc., its subsidiaries and affiliates.

## Forward-Looking Statements

In addition to historical information, this Form 10-K contains statements relating to our future results (including certain projections and business trends) that are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and are subject to the “safe harbor” created by those sections. Words such as “expects”, “anticipates”, “intends”, “plans”, “believes”, “estimates”, “suggests”, “appears”, “seeks”, “will” and variations of such words and similar expressions are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results and performance to be materially different from any future results or performance expressed or implied by these forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the section entitled “Item 1A – Risk Factors.” Readers should also carefully review the “Risk Factors” section contained in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed by us in fiscal year 2013.

Although we believe that these statements are based upon reasonable assumptions, we cannot guarantee future results and readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s opinions only as of the date of this filing. There can be no assurance that (i) we have correctly measured or identified all of the factors affecting our business or the extent of these factors’ likely impact, (ii) the available information with respect to these factors on which such analysis is based is complete or accurate, (iii) such analysis is correct or (iv) our strategy, which is based in part on this analysis, will be successful. The Company undertakes no obligation to update or revise forward-looking statements.

## PART I

### Item 1. Business.

#### Overview of Our Company

We are a leader in healthcare staffing with a primary focus on providing nurse, allied and physician (locum tenens) staffing services and workforce solutions to the healthcare market. We believe we are one of the top two providers of nurse and allied staffing services, one of the top four providers of temporary physician staffing (locum tenens) services, and one of the top five providers of retained physician and healthcare executive search services. We are also a leading provider of education and training programs specifically for the healthcare marketplace. We report our financial results according to three business segments: (1) nurse and allied staffing, (2) physician staffing, and (3) other human capital management services.

In February 2013, we sold our clinical trial services business. Accordingly, this business segment has been reclassified as discontinued operations on our consolidated financial statements contained in this Report. For additional information, see Footnote 3 – Assets Held for Sale and Discontinued Operations contained elsewhere in this report.

Our operations reflect a diversified revenue mix across healthcare customers. For the full year 2012, our revenue from continuing operations was \$442.6 million. Our nurse and allied staffing business segment was 63% of revenue and is comprised of travel nurse, per diem nurse and allied health staffing. Our physician staffing business segment was 28% of our revenue and consists of temporary physician staffing services with placements across multiple specialties. Our other human capital management services business segment was 9% of our revenue and consists of education and training, as well as retained search services related primarily to physicians, allied health and healthcare executives. On a company-wide basis, we have approximately 4,000 contracts with hospitals and healthcare facilities, and other healthcare organizations to provide our staffing services and workforce solutions. In 2012, no single client accounted

for more than 3% of our revenue. Our fees are paid directly by our clients, and in certain instances, by third-party vendor managers. As a result, we have no direct exposure to Medicare or Medicaid reimbursements. For additional financial information concerning our business segments see Note 17 to the consolidated financial statements - Segment Information, contained elsewhere in this report.

## Healthcare and Demographic Influences on Our Business

### Health Care Reform and the Health Workforce

Health care reform legislation known as the Affordable Care Act was enacted into law in March 2010, and incorporates the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. The primary objective of the Affordable Care Act is to decrease the number of uninsured Americans and reduce the overall costs of health care by improving healthcare outcomes and streamlining the delivery of health care. A number of provisions of the Affordable Care Act take effect over several years and began in 2010 and are directed at employers, individuals, insurance providers and the health workforce. One of the major aspects of the Affordable Care Act is providing health insurance coverage for uninsured nonelderly people. According to an NBC News report of the Congressional Budget Office's Estimate of the Effects of the Affordable Care Act on Health Insurance Coverage (February 2013), the Congressional Budget Office projects approximately 27 million previously uninsured people will be covered by health insurance by 2017. This number was revised from its March 2012 projection that 32 million to 34 million previously uninsured people would receive health insurance coverage under the Affordable Care Act.

The Affordable Care Act is expected to create a large demand for medical professionals to accommodate the significant number of new patients that will begin using their health benefits. With respect to healthcare workforce, provisions of the Affordable Care Act are intended to: improve access by increasing the supply of needed health workers, particularly primary care practitioners; increase efficiency and effectiveness by encouraging systems redesign; address problems of mal-distribution; and improve the quality of care through improved education and training. It also establishes an infrastructure to collect and disseminate better data and information to inform public and private decision making around the supply, education and training and use of healthcare workers (Association of American Medical Colleges (AAMC) Center for Workforce Studies, April 2010).

#### Demand Influences

The long-term macro drivers of our business are demographic in nature and consist of a growing and aging U.S. population demanding more healthcare services and an aging workforce of healthcare professionals. Additionally, there are projected shortages of healthcare professionals including registered nurses (RNs) and physicians.

According to the most recent report by the Centers for Medicare & Medicaid Services (CMS), in 2011 health spending in the U.S. grew by 3.9%, which was the slowest annual rate of increase in the 52 years that federal agencies have been tracking such data. In 2011, health expenditures increased to \$2.7 trillion from \$2.6 trillion in 2010 and from \$2.5 trillion in 2009. The low rate of growth in overall health spending in 2011 largely reflects the lingering effects of the 2008 recession and the modest recovery that followed, which contributed to slower growth in the use of health care goods and services, lower medical inflation, reduced private health insurance enrollment, and employer efforts to control spending.

In 2011, Medicare spending grew 6.2% to \$554 billion and Medicaid spending increased 2.5% to \$408 billion over the prior year. Hospital spending grew 4.3% to \$850 billion. Physician and clinical services spending grew 4.3% to \$541 billion. The CMS analysis also noted that provisions of healthcare legislation under the Patient Protection and Affordable Care Act had minimal effects on health spending growth in 2010 and 2011 as the main provisions – the individual mandate and health insurance exchanges – do not take effect until 2014.

In 2012 and 2013, health spending was estimated to continue to grow modestly at 4.2% and 3.8%, respectively. In 2014, national health spending is projected to accelerate to 7.4% primarily due to implementation or expansion of provisions under the Affordable Care Act. Longer-term, CMS expects national health spending over the period of 2015-2021 to grow at an average rate of 6.2% annually, reflecting greater demand for healthcare services due to both an increasing and aging population, several provisions of the Affordable Care Act, and generally improving economic conditions.

The U.S. population grew by 9.7% to 308.7 million people in the decade from 2000 to 2010, according to U.S. Census Bureau data; and life expectancy for Americans is nearly 78 years, the highest in U.S. history, according to the most recent government data for 2007. Between 2010 and 2050, the U.S. Census Bureau projects the American population to grow 42% to 439 million people and also to grow older driven largely by the baby boomer generation moving into the ranks of the 65 and older population. The number of people age 65 and older is projected to more than double from 40.2 million in 2010 to 88.5 million in 2050, while over this same period the number of people age 85 and older is projected to grow from 5.8 million to 19 million, according to a May 2010 report by the U.S. Department of Commerce.

Utilization of healthcare services is significantly higher among older people. In 2007, people age 65 and older averaged seven doctor visits per year while people aged 45-65 average less than four visits annually, according to a 2010 report by the U.S. Department of Health and Human Services. This report also found that approximately one-third of people age 65 and older were admitted to acute care hospitals for treatment, which is about three times

the comparable rate for people under age 65. The American Hospital Association (AHA) projects the share of hospital admissions for the over-65 age group to rise from 38% in 2004 to 56% in 2030.

We believe demand for our nurse, allied and physician staffing services is primarily influenced by two factors: (1) national labor market dynamics that affect the number of hours worked by healthcare professionals, especially nurses, and (2) the strength or weakness in acute care hospital admissions relative to expectations, as well as the volume of patients at other medical facilities and physician offices. During 2012, demand (defined as open orders from clients) improved significantly for our nurse and allied staffing services and also improved for our physician staffing services. However, overall demand for our healthcare staffing services remains below levels prior to the economic downturn that began in the fall of 2008.

With respect to temporary healthcare professionals, a significant downturn in the national labor market following the recession of 2008 triggered RNs to offer more hours of service directly to hospital employers at wages hospitals were willing and able to pay. This resulted in a steep decline in the demand for our temporary nurse and allied staffing services, and to a lesser extent, our physician staffing services. Physicians have historically been revenue generators for hospitals, healthcare facilities and practice groups while nurses are not a specifically reimbursed cost in the delivery of care.

### Supply Influences

Overlaid on an expected increase in demand for healthcare services is a projected shortage of RNs that is caused by an aging nurse workforce and a nurse education system constrained by both an aging faculty and lack of accredited teaching facilities. There is also a growing shortage of physicians in both hospitals and practice groups that is influenced by constraints in the number of graduates from U.S. medical schools combined with an aging workforce that is expected to experience substantial retirements over the next decade. Healthcare reform legislation is also expected to have a future impact on the shortage of RNs and physicians caused by adding tens of millions of new patients to the reimbursement system.

Despite a high national unemployment rate in 2012 and flat job growth compared to the prior year, the U.S. healthcare workforce continued to expand. The Bureau of Labor Statistics reported that healthcare employers added 45,000 new jobs in December 2012, bringing the 2012 total of new jobs created in this sector to 338,000, a 7.3% increase from the prior year.

RNs are projected to be the top occupation in terms of job growth through 2020, according to the Bureau of Labor Statistics in its February 2012 report, *Employment Projections 2010-2020*, in which the number of employed nurses is expected to grow 26% from 2.74 million in 2010 to 3.45 million in 2020. During the past several years, hospital employment of RNs increased significantly due to several factors related to the effects of the economic downturn and weak national labor market: full and part-time staff RNs increased the number of shifts working directly for hospital employers, many retired RNs returned to bedside care, older RNs contemplating retirement remained in the workforce longer to maintain household income, and there was an increase in younger RNs entering the workforce. In the last recession, in 2007 and 2008, hospital employment of RNs increased by an estimated 243,000 full-time equivalents – the largest increase during any 2-year period in the prior four decades. These factors served to substantially ease the shortage of RNs working in hospitals. Looking ahead, knowledgeable industry researchers believe that over the next several years, many RNs who entered the workforce during the economic downturn are likely to leave their jobs once the economy fully recovers, making it likely that growth in demand for RNs over the next few years will exceed the projected growth in the workforce, leading to renewed shortages of RNs in the near-term (*New England Journal of Medicine*, April 2012). And in the longer-term, large shortages of RNs are projected nationwide with the onset of a substantial shortfall of RNs expected to occur around 2018 and growing to approximately 260,000 by 2025 (*Health Affairs*, June 2009).

Physicians are expected to be in short supply as well. While the root cause of this shortage dates back to the 1980s and 1990s when medical schools capped enrollment, the U.S. is expected to face a shortage of more than 90,000

primary care, surgical and medical specialty physicians by 2020 – a number that will grow to more than 130,000 by 2025, according to analysis by the Association of American Medical Colleges (AAMC) Center for Workforce Studies (June 2010). This analysis factored in an expansion of health care insurance as a result of the Affordable Care Act along with physician retirements. The AAMC expects nearly one-third of all physicians will retire in the next decade. Additionally, while the number of applicants to U.S. medical schools is increasing, it will not keep pace with expected future demand. The U.S. Department of Health and Human Services estimates that the physician supply will increase by only 7% in the next 10 years.

The supply of healthcare professionals (HCPs) in the marketplace is dependent upon the number of HCPs entering or already active in their respective professions, less the number of professionals leaving or retiring from the workforce. The supply of RNs available for our staffing services is variable and impacted by national labor market dynamics and demand-related factors which influence RNs to gauge their willingness to work temporary assignments, be directly employed by hospitals as staff nurses or working in non-hospital settings such as insurance companies, health clinics and doctor offices. The supply of physicians available for our physician staffing services is variable and is influenced by several factors, including the desire of physicians to work temporary assignments, along with the desire of older physicians to work fewer hours, work-lifestyle balance among younger physicians, and the trend toward more female physicians in the workforce who traditionally work fewer hours than their male counterparts.

## Influences on Our Customers

Hospital and healthcare facility customers comprise the majority of our revenue base. Typically, they provide medical care on a 24 hour/7 day a week basis, which requires RNs, physicians and other healthcare professionals to be staffed around the clock. Labor costs have historically been the largest component of a hospital's operating budget with nursing care accounting for about half of this amount or a quarter of total expenditures. Hospitals are capital-intensive organizations that are paid for their services through reimbursements from the CMS, by insurance companies paying their members' covered claims, and by private-pay individuals. Our fees are paid directly by our clients and in certain instances by vendor managers. As a result, we have no direct exposure to Medicare or Medicaid reimbursements.

Since the beginning of 2003, growth in hospital in-patient admissions has been relatively flat. In addition, hospitals, healthcare facilities and physician practice groups have had to contend with changes to government reimbursements for their services and changes in legislation and agency regulations, along with a large pool of uninsured patients. In addition, in 2011, uncompensated care (bad debt and charity care) by hospitals reached a record \$41.1 billion and represented 5.9% of total expenses, which was relatively consistent with the prior 5-year period. Among other things, these factors have been compounded by high unemployment and higher deductibles and co-pays for those with health insurance coverage.

During 2012, hospitals and health systems continued to operate in an environment characterized by a slow recovering economy and emerging healthcare policy changes. These factors have turned up the pressure in the near- and longer-term to increase efficiency, devise new payment models and create new models of coordinated care across hospitals, health systems, other medical providers and the community with the result of improved quality of care and better health outcomes, according to the American Hospital Association (AHA). More specifically, hospitals and other health care providers were reacting to and complying with the Patient Protection and Affordable Care Act, and subsequent changes.

In addition, many hospitals are currently undergoing electronic medical record (EMR) implementations aided by grants available to healthcare facilities under the Health Information Technology for Economic and Clinical Act (HITECH Act) – adopted as part of the American Recovery and Reinvestment Act – to improve the quality of healthcare by reducing medical errors and lowering costs through the computerization of America's health records by 2015. See Regulations Affecting Our Clients for more information about this Act. Hospitals are also going through ICD-10 implementation (International Classification of Diseases, Tenth Revision), which is a new version of the medical procedure codes used for reimbursement, quality and patient safety reporting. Transitioning to the new coding system is a significant undertaking that requires not just technology upgrades, but also training of clinical, coding and financial staffs. As a comparison, the new ICD-10 coding system contains more than 141,000 codes and accommodates a host of new diagnoses and procedures, whereas the prior ICD-9 coding system contains approximately 17,000 codes.

Physicians are increasingly becoming employees of hospitals or health systems due to business pressures and costs of operating private practices. Hospitals seek to gain market share by increasing their referral base and capturing admissions while physicians are facing a combination of factors that include stagnant reimbursement rates, increased regulatory burden, rising costs, greater risk associated with operating a private practice, and an increased desire for a better work-life balance. We believe this shift has reduced the demand from hospitals for temporary physicians. In 2009, more than 50% of medical practices were hospital-owned as compared to about 26% in 2005, according to annual physician compensation surveys by the Medical Group Management Association (MGMA).

Looking ahead, there are a number of key issues hospitals and health systems are expected to face in 2013, according to Becker's Hospital Review (September 2012) including:

Hospital-hospital consolidation

Hospital-physician alignment

Payor-payor and payor-provider consolidation

Physician shortage and physician burnout

Sustainability of physician employment

Accountable care organizations

## Nurse and Allied Staffing

We are a leading provider of nurse and allied staffing services in the U.S. Nurse and allied staffing is our largest business segment with revenue of \$277.8 million in 2012. The majority of our revenue is generated from staffing RNs on long-term contract assignments (typically 13-weeks in length) at hospitals and health systems. We also staff allied health professionals on long-term contract assignments and staff RNs, licensed practical nurses and certified nurse assistants on short-term per diem assignments through our network of local offices. Our allied and other healthcare professionals represent a wide range of specialties that include operating room technicians, rehabilitation therapists, radiology technicians, respiratory therapists, radiation therapy technicians, nurse practitioners, and physician assistants.

We market our nurse and allied staffing services primarily to acute care hospitals and health systems, and provide our clients with staffing solutions through our Cross Country Staffing (CCS) and Allied Health Group brands. Our clients provide health and medical services across a broad range of clinical settings in the for-profit and not-for-profit sectors throughout the U.S., including acute care hospitals, physician practice groups, skilled nursing facilities, nursing homes and sports medicine clinics, and, to a lesser degree, non-clinical settings such as home care and schools.

Our nurse and allied staffing businesses are certified by The Joint Commission under its Health Care Staffing Services Certification Program.

CCS is our largest brand. The vast majority of our activities are designed to help a diverse customer base of hospitals and health system clients meet their ongoing staffing needs for temporary nurses and allied health professionals. During 2012, we worked with more than a thousand hospitals and health system clients. Additionally, as a part of its business strategy, CCS provides comprehensive Managed Service Provider (MSP) solutions to large hospitals and health systems throughout the U.S. to manage their temporary clinical staffing. These MSP contracts are specifically tailored to each client based on their workforce goals and financial targets. Our MSP engagements typically incorporate one or more of our contract nurse, contract allied and/or per diem staffing solutions. Typically, such arrangements require CCS to:

- negotiate contracts with subcontractors in order to help meet the client's fill rate expectations

- verify that all nurses provided both by CCS and subcontractors meet CCS' credential requirements and other standards and testing requirements established by the client

- verify insurance coverage of the subcontractors and their candidates

- manage orders for open positions from the client and distribute those needs to subcontractors as required

- interview candidates presented to ensure they meet the client's specifications

- consolidate and reconcile the timecard approval and invoicing process for services provided by CCS and all subcontractors

- distribute payments to subcontractors for services provided to the client

- capture and analyze data for the benefit of the client

These services are particularly beneficial to larger facilities and systems that require many healthcare professionals across a broad spectrum of medical disciplines and specialties. For the full year 2012, approximately 29% of our nurse

and allied staffing volume was at MSP client facilities. In addition to directly supplying a large majority of client needs under these MSP programs, CCS has relationships with hundreds of subcontractors throughout the U.S. to ensure that clients have access to a large pool of candidates to meet their staffing needs.

Another component of our business is contract staffing for hospitals and health systems undergoing electronic medical record (EMR) technology implementations. In these situations, we supply contract temporary healthcare professionals to provide patient care while hospital staff RNs are away in classroom settings undergoing training and to provide support to the staff RNs in utilizing the EMR technology upon their return to bedside care. We expect that staffing related to EMR technology implementations will be one of the growth drivers of our nurse and allied staffing segment in 2013.

## Overview of the Nurse and Allied Staffing Industry

Clients today select between contract and/or per diem staffing solutions in order to meet their temporary staffing needs. The term “contract staffing” is typically associated with travel nurse or travel allied health professionals. Contract staffing involves placement of nursing or allied healthcare professionals on a contract basis, typically for a 13-week assignment although assignments may range from several weeks or longer than three months. Contract assignments usually involve relocation to the geographic area of the assignment. Both the contract and per diem models provide our clients with a more flexible cost model to better manage variability in their staffing needs due to changes in demand. Often, the contract model is preferred because it also provides a pool of potential full-time job candidates from outside the local market, and enables healthcare facilities to provide their patients with a greater degree of continuity of care versus a per diem solution. The staffing company generally employs the healthcare professional and is responsible for providing them with customary employment benefits, including travel reimbursements, and for coordinating housing arrangements. Per diem nurse staffing comprises the majority of the outsourced temporary nurse staffing market and involves the placement of locally-based healthcare professionals on short-term assignments, often for daily shift work, with little advance notice by the hospital client. Consequently, housing and travel reimbursements are generally not required for this mode of staffing. In 2012, the market for travel nurse and allied staffing was estimated to be approximately \$4.4 billion and the market for per diem staffing was estimated to be \$2.8 billion, according to industry sources.

## Recruiting

We operate differentiated brands – Cross Country TravCorps, MedStaff Healthcare Solutions, NovaPro, Cross Country Per Diem, CRU-48, Allied Health Group, MRA Search and Assignment America – to recruit nurses and allied healthcare professionals on a domestic and international basis. We believe RNs and allied health professionals are attracted to us because we offer a wide range of diverse assignments in attractive locations, competitive compensation and benefit packages, as well as a high level of customer service. In 2012, more than ten thousand healthcare professionals applied with us through our recruitment brands.

Historically, more than half of our field employees have been referred to us by other healthcare professionals. We market our brands on the Internet including extensive utilization of social media, which has become an increasingly important component of our recruitment efforts. We maintain a number of websites to allow potential applicants to obtain information about our brands and assignment opportunities, as well as to apply online. We also advertise in trade publications.

Our recruiters are an essential element of our staffing business, responsible for establishing and maintaining key relationships with candidates for the duration of their employment with our Company. Our recruiters work with candidates before, during and after their employment with us. We believe our retention rate of healthcare professionals is a direct result of these relationships. Recruiters match the supply of qualified candidates in our databases with the demand for open orders posted by our hospital clients. At year-end 2012, we had 96 recruiters in our nurse and allied staffing segment.

Our recruiters utilize proprietary computerized databases of positions to match assignment requirements with the experience, skills and geographic preferences of candidates. Once an assignment is selected, our account managers review the candidate’s application package before submitting it to a hospital client for consideration. Account managers are knowledgeable about the specific requirements and operating environment of the hospitals that they service.

## Contracts with Field Employees and Hospital Clients

Each of our contracted field employees works for us under the terms of a written agreement. Contract assignments are typically 13-weeks in duration and can be shorter or longer. The vast majority of our field employees are hourly whose agreements with us specify the hourly rate they will be paid and any other benefits they are entitled to receive during the assignment period. We bill clients at an hourly rate and assume all employer costs, including payroll, withholding taxes, benefits, professional liability insurance and Occupational Safety and Health Administration (OSHA) requirements, as well as any travel and housing arrangements.

#### Operations

We operate our contract staffing business through a relatively centralized business model servicing all of the assignment needs of our field employees and client healthcare facilities through operation centers located in Boca Raton, Florida; Malden, Massachusetts; Tampa, Florida; Newtown Square, Pennsylvania; and Norcross, Georgia. In addition to the key sales and recruitment activities, these centers also perform support activities such as coordinating housing, payroll processing, benefits administration, billing and collections, travel reimbursement processing, customer service and risk management. Our per diem staffing services are provided through a network of 19 branch offices serving major metropolitan markets predominantly located on the east and west coasts of the U.S.

Hours worked by field employees are recorded by our operations system, which then transmits the data directly to Automatic Data Processing, Inc. for payroll processing. Client billings are typically generated using time and attendance data captured by our payroll system. Our payroll department also provides customer support services for field employees.

During 2012, we had an average of approximately 1,100 apartments open under lease throughout the U.S. Our housing staff typically secures leases and arranges for furniture rental and utilities for field employees at their assignment locations. Apartment leases are typically three months in duration to match the assignment length of our field employees. Beyond the initial term, leases can generally be extended on a month-to-month basis. We typically provide accommodations at no cost to the healthcare professional on assignment with us based on our respective recruitment brand's practices. We believe that our economies of scale help us secure competitive pricing and favorable lease terms.

### Demand and Supply Drivers

Using temporary personnel enables healthcare providers to manage their total staffing levels of internal and external nursing resources to better match variability of in-patient admissions, seasonal fluctuations, and other factors such as facility expansion and staff training activities.

The market for our nurse staffing services is determined by the demand from hospital and health system clients and the available supply of RNs and other healthcare professionals. We believe demand is a function of both the dynamics of the national labor market and its impact on RNs and their spouses (approximately 75% of RNs in the U.S. are married), as well as hospital admission trends relative to expectations (Health Resources and Services Administration (HRSA) (September 2010)). Each of these factors influences the number of shifts or hours that full and part-time RNs are willing to work directly for hospitals at prevailing wages that hospitals are able to pay. In general, we believe nurses are more willing to seek contract assignments with us during relatively high levels of industry demand for contract employment, and conversely, are more reluctant to seek contract assignments during and immediately following periods of weak industry demand for contract employment. We also believe demand for contract nurse staffing services will be favorably impacted in the long-term by an expanding and aging population and an increasing shortage of nurses. From 2008 to 2010, RN turnover and vacancy rates at hospitals decreased year-over-year due primarily to economic conditions, according to a 2012 Advisory Board report. However, from 2010 to 2011, these metrics reversed the trend of the prior several years likely reflecting increasing confidence in the labor market. Exhibiting the greatest increase was the vacancy rate for bedside nurses, which the Advisory Board report states may be an early indicator of the return of nursing shortage conditions.

During 2012, while hospital admission trends continued to remain relatively flat and the U.S. economy achieved a slight improvement and national unemployment improved somewhat but remained high, we experienced an increase in demand for our nurse and allied staffing services that strengthened over the course of the year from a very weak start. The improvement in demand was broad-based and reflected staffing associated with hospital electronic medical record implementations and staffing needs at our MSP accounts.

Historically, high national unemployment typically results in RNs increasingly seeking employment as hospital staff nurses and those already employed as staff nurses become more willing to work more hours at prevailing wages, which combine to reduce the need for our outsourced staffing services. The reverse begins to occur as the economy and more specifically the labor markets improve, although there is a lag between the improvement in demand for our nurse and allied staffing services and the improvement in supply of RNs and other healthcare professionals.

In connection with a statement by the Tri-Council of Nursing (July 2010), Dr. Peter Buerhaus, Associate Dean of Vanderbilt University's School of Nursing, stated that he believes it is important to look beyond the short-term

environment where hospitals have largely been able to employ all the RNs they want at prevailing wages due to the uncertainty over key economic factors. Buerhaus outlined that once the jobs recovery begins and RNs' spouses rejoin the labor market, many currently employed RNs could leave the workforce where their exit could be swift and deep. This includes many of the more than 100,000 RNs over the age of 50 that re-entered the workforce during 2007 and 2008, who are a part of the nearly 900,000 working RNs over the age of 50, of which Buerhaus expects large numbers of them to retire in the years ahead – independent of the pace and intensity of a jobs recovery. More recently, Buerhaus found a 62% increase in the number of 23-26 year olds who entered the RN workforce between 2002 and 2009 (Health Affairs, December 5, 2011). Despite this increase in younger RNs, the study concluded that the nursing shortage is not over given the demand for nursing care by older adults, new opportunities for nurses through healthcare reform, and the need for more highly educated RNs.

## Educating Nurses

The most commonly reported initial nursing education of RNs in the U.S. is the Associate Degree in Nursing, representing 45.4% of nurses. Bachelor's or graduate degrees were received by 34.2% of RNs, and 20.4% graduated from hospital-based diploma programs. More than 21% of RNs earned an academic degree prior to their initial nursing degree. More than two-thirds of RNs reported working in a health occupation prior to their initial nursing education.

All employees, including all current officers who are not executive officers, as a group (3)

130,000

1,462,500

136,500

26,426

- (1) Calculated by determining the difference between the market value of the shares offered at September 14, 2007 (\$12.30) and the purchase price of \$11.25 per share.
- (2) Mr. Scharnott resigned from the Company on March 12, 2007. Because Mr. Scharnott was one of our most highly compensated executive officers during the last completed fiscal year, Mr. Scharnott is considered a named executive officer under the securities laws and therefore appears in the table above. Mr. Scharnott will not be offered shares of common stock under this proposal.
- (3) This group includes 42 management employees, including executive officers, sales managers, general managers, and national account managers.
- (4) For an explanation of this bonus, please see [Tax Considerations](#) below.

## Tax Considerations

For those certain management employees who purchase our common stock under the terms of this Proposal No. 3, the difference between the market value of the purchased shares measured as of the date of purchase and the purchase price of \$11.25 per share will be taxable compensation income. The Board has approved paying a cash bonus to all participating employees to offset a portion of the taxes resulting from the purchase of our common stock under the terms of this Proposal No. 3. Because this bonus will also be taxable compensation income, the bonus will be grossed up to include the appropriate federal and state taxes on compensation income. After deducting these taxes, the net bonus paid will equal 13% of the difference between the market value and the purchase price of the purchased shares. If the market value of the purchased shares as of the date of purchase equals \$12.30 per share (the market price as of September 14, 2007), then the net bonus paid will be

as indicated in the column in the table above titled "Tax Bonus."

**Registration with the SEC**

We intend to file a Registration Statement on Form S-8 relating to the issuance of shares of our common stock under this proposed offering with the SEC pursuant to the Securities Act of 1933, as amended, as soon as is practicable after approval of the proposal by our shareholders.

**Effects of the Management Sale**

The ownership percentage of our current holders of common stock will be diluted by the issuance of additional shares to management. If the management sale is approved and sale of stock were to close, a shareholder owning 10,000 shares of common stock would see their percentage of ownership drop from 0.167% to 0.164%, assuming that the shareholder purchased its pro rata portion of the shares offered in the Rights Offering.

**Reasons for Seeking Shareholder Approval**

The Nasdaq Stock Market requires shareholder approval when a purchase plan is to be established pursuant to which stock may be acquired by management at a discount.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR"**

**PROPOSAL NO. 3 APPROVING THE SALE OF SHARES OF COMMON STOCK**

**TO CERTAIN MANAGEMENT EMPLOYEES**

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**PROPOSAL NO. 4**

**APPROVAL OF AN INCREASE IN THE**

**AUTHORIZED AMOUNT OF COMMON STOCK**

**General Background**

Our Articles of Incorporation currently authorize 12,000,000 shares of common stock. As of September 14, 2007, there were 5,997,177 shares of common stock issued and outstanding. There are 805,014 shares of common stock reserved for issuance under existing stock option plans, of which 143,250 shares are issuable upon the exercise of outstanding options granted under our existing stock option plans. There are only 5,197,809 authorized and unissued shares of common stock available for future issuance.

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As further explained in Proposal No. 1 of this Proxy Statement, we are seeking shareholder approval to conduct a rights offering pursuant to which each holder of our common stock will receive, for each share they own as of the record date for the rights offering, one right to purchase 0.2 shares of our common stock at \$11.25 per share. If approved and completed, the Rights Offering will result in the issuance of approximately 1,200,000 shares of common stock for an aggregate purchase price of approximately \$13,500,000. As further explained in Proposal No. 3 of this Proxy Statement, we are seeking shareholder approval to issue up to 130,000 shares of common stock to certain management employees at \$11.25 per share. If the issuances contemplated by both proposals occur, the number of authorized and unissued shares available for future issuance will drop below 3,900,000 shares.

On July 9, 2007, our Board unanimously adopted a resolution, subject to shareholder approval, to increase the authorized number of shares of common stock from 12,000,000 to 20,000,000 and the total shares of capital stock to 21,000,000. If the shareholders approve this Proposal No. 4, an increase in our

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authorized shares of common stock will be effected through the filing of a certificate of Amendment to our Articles of Incorporation with the office of the Indiana Secretary of State, amending Article V of our Articles of Incorporation to authorize 20,000,000 shares of common stock and total shares of capital stock of 21,000,000, as soon as practicable following the Special Meeting, to be effective upon such filing. Upon approval of the proposed amendment to our Articles of Incorporation, Article V would read as follows:

### **ARTICLE V**

The total number of shares which the Corporation shall have authority to issue is twenty-one million (21,000,000), consisting of one million (1,000,000) shares of Preferred Stock, without par value, and twenty million (20,000,000) shares of Common Stock, without par value.

The Company's Articles also authorize 1,000,000 shares of preferred stock. There are currently no shares of preferred stock outstanding and Proposal No. 4 does not propose to increase the number of authorized shares of preferred stock.

### **Reasons for Increasing the Authorized Number of Shares of Common Stock**

The additional shares of common stock authorized upon adoption of this proposal will be available for issuance from time to time as determined by the Board, without further action by the shareholders and without first offering the shares to the shareholders. The proposed increase will ensure, for the foreseeable future, that a sufficient number of shares will be available, if needed, for issuance in connection with possible future actions approved by the Board, including stock splits, stock dividends, acquisitions, financings, rights offerings, employee benefit programs or other corporate purposes, or upon exercise of stock options or warrants. The Board believes that the availability of the additional shares for such purposes without delay or the necessity for a shareholder vote (except as may be required by applicable law or regulatory authorities or by the rules of any stock exchange on which the Company's securities may be listed) will be beneficial to the Company by providing it with the flexibility required to respond to future business opportunities and needs as they arise. The availability of additional shares of authorized common stock will enable us to act promptly when the Board determines that the issuance of additional shares of common stock is advisable. Assuming the approval by shareholders of this proposal and approval of the Rights Offering and management sale, there will be approximately 11,868,000 authorized and unissued shares of common stock that are not reserved for any specific use and are available for future issuance. If this proposal is approved, but the Rights Offering and management sale proposals are not approved, there would be over 13,100,000 authorized and unissued shares of common stock available for future issuance that are not reserved for any specific use.

### **Anti-Takeover Effect**

An increase in the number of shares of common stock that the Company is authorized to issue could have a potential anti-takeover effect with respect to the Company, although our management has not proposed the increase for that reason and does not presently anticipate using the additional authorized shares for such a purpose. The potential anti-takeover effect of the proposed amendment arises because the Company could issue additional shares of common stock, up to the total authorized number, thereby diluting the shareholdings and related voting rights of then existing shareholders in proportion to the number of any additional shares issued.

### **THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE**

### **"FOR" PROPOSAL NO. 4 APPROVING AN INCREASE IN THE AUTHORIZED**

### **AMOUNT OF COMMON STOCK**



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## COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

### Compensation Discussion and Analysis

#### Summary

We believe that our compensation plan as it relates to our named executive officers should be aligned with the Company's strategic plan, its operating performance, and increasing management ownership in the Company. Our objective is to attract and retain highly qualified executives and to align the interest of our Board of Directors with our senior management team in efforts to facilitate strong leadership in an environment that creates and promotes productivity and goal oriented results. In order to meet these objectives, the Compensation committee has met numerous times over the past several years and conducted market studies and analysis to ensure that we are providing a competitive complete package as it relates to our senior management team. Our compensation plan currently includes the following components and our general objectives as they relate to each:

**Annual Base Salaries** Base salaries are based on job responsibility, individual performance, experience, skill level, and market practices.

**Annual Non-Equity Incentive Plan Awards and Performance Bonuses** Non-Equity Incentive Plan Awards and Performance Bonuses are intended to reward outstanding performance and efforts as they relate to the Company's strategic plan and are tied to items including Return on Equity. The Board reserves the right at any time to award discretionary bonuses to senior management based on outstanding performance or other factors.

**Long-Term Incentives** In efforts to increase management ownership in the Company, our plan links performance to our strategic plan and our shareholder interests in efforts to provide long-term shareholder value.

**Executive Retirement Plan** In efforts to retain a highly qualified management team, our executive officers, upon approval by the Board of Directors, participate in a supplemental retirement program which is based on base wages, years of service, and other criteria.

**Perquisites** Perquisites are minimized to promote team oriented results.

**Severance Benefits** We continue to support our executive team and want to provide reasonable and equitable protection consistent with comparable practices of comparable companies.

#### Benchmarking

We use a variety of resources including SEC filings as they relate to our customers, suppliers, and other companies of our size to assist in establishing our compensation programs for our senior executives. Our major competitors are not publicly traded and therefore we do not have access to their compensation information to make appropriate comparisons at this level. Along with current market rates for companies of our size, structure, and reporting responsibilities, we utilize market surveys, Board member experience, external compensation studies, and engage the assistance of our advisors and contacts within the industry to help supplement our decision making process. While the Manufactured Housing industry, which represents approximately 44% of our revenue base, has been operating at the lowest levels in more than 40 years, we have worked to provide an appropriate compensation package that recognizes the inherent limitations on organic growth while fully recognizing the significant efforts put in by our management team to not only execute on strategies in conjunction with our strategic plan but to continue to promote a culture of performance based results and team oriented goal setting. Additionally, with the change in management personnel related to Paul E. Hassler being appointed President and Chief



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Executive Officer in 2004, we recognized that our new senior management team, while experienced within the industry and with the Company, owned very little Company stock. Accordingly, we have taken on the initiative of increasing management's ownership of Company common stock through the issuance of both restricted and unrestricted stock awards in conjunction with our 1987 Omnibus Stock Option Program as amended.

### Equity Trading Restrictions

The Company has a policy with regards to a mandatory blackout period related to equity transactions which starts on the 15<sup>th</sup> day of the month ending in a reporting period (March, June, September, and December) and ends three days after the public release of the financial information for that reporting period. During this period, Section 16 insiders and other management employees who have access to inside information are precluded from trading in the public market, any types of company owned equity securities. Additionally, the Company precludes any Section 16 insider, as defined by the Securities and Exchange Commission, Director, Officer, or Employee from trading in the public market, or any other market, based on information that is not made available to the general public.

The components of our executive compensation plan as currently established by the Compensation Committee include the following:

Base Salary

Non-Equity Incentive Plan Awards

Annual Performance Bonus

Stock Awards

Non-Qualified Stock Options

Executive Retirement Plan

### Base Salary

The Compensation Committee reviews and approves the base salaries of named executives each year, as well as at the time of promotion, change in job responsibilities, or any other change deemed to be a material event. Base salaries are set on the first day of January of each year. The Compensation Committee sets the salary for the President and CEO, and approves the base salaries for the other named executives based on recommendations by the President and CEO. The Compensation Committee recommended and the Board subsequently approved a base salary increase for the Named Executive Officers based on recommendations by Mr. Hassler, President and CEO, as well as a review of individual performance and trends in the marketplace effective January 1, 2007. The following table summarizes 2006 and 2007 base salaries:

<u>Name</u>	<u>2006 Base Salary</u>	<u>2007 Base Salary</u>	<u>% Increase</u>
Paul E. Hassler	\$320,000	\$335,000	4.7%
Andy L. Nemeth	200,000	217,000	8.5%
Gregory J. Scharnott	200,000	207,000	3.5%

### Non-Equity Incentive Plan Awards

The Annual Non-Equity Incentive Plan Awards are reviewed and approved each year and are based on the achievement of financial targets. The 2006 target was based on the Company achieving a level of return on equity computed as pre-tax net income divided by Beginning Equity. The award is calculated as a percent of base salary and payouts start at \$0 and are capped at 81% of base salary. The formula was set-up primarily during this time period to take into account the handicapped market environment with regards to the Manufactured Housing industry and attainment of the Company's



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strategic financial targets in conjunction with its strategic plan. Given the limited trading activity of the Company's stock at this time, due to the large concentration of institutional investors and limited market float, we believe that this formula accurately takes into account return to shareholders and overall alignment with its financial goals and objectives. This formula is used as a key measure of the Company's performance. While this earnings target has been used in recent years, the Compensation Committee reserves the right to modify, cancel, change, or reallocate any components of this calculation or criteria at any time. The awards in conjunction with the 2006 operating results were recommended by the Compensation Committee and unanimously approved by the Board of Directors.

Actual and potential non-equity incentive plan awards for 2006 are set forth in the table below. Potential 2006 awards are expressed as a percentage of base salary.

### Potential 2006 Performance Bonus

(as a percentage of base salary)

**Actual 2006**

**Performance**

<b>Name</b>	<b>Bonus</b>	<b>Threshold</b>	<b>Target</b>	<b>Maximum</b>
Paul E. Hassler	\$66,560	0%	16%	81%
Andy L. Nemeth	41,600	0%	16%	81%
Gregory J. Scharnott	41,600	0%	16%	81%

### **Annual Performance Bonus**

We believe in rewarding management in situations outside of the Annual Non-Equity Incentive Plan for accomplishments that benefit the shareholders and short and long-term goals of the Company and its strategic plan. Due to the depressed conditions in the Manufactured Housing industry, which are beyond the Company's control, management must continue to work and make decisions that do not immediately have a financial impact on the Company, but promote the long term goals and direction as they relate to the strategic plan. In these situations, it is our belief that our management team should be rewarded to decrease the gap between financial results and actual operating management and performance.

### **Stock Awards**

#### Annual Performance Based Stock Awards:

We believe that increasing senior management's ownership in the Company is critical to our long-term strategic plan and keeping management goals aligned with increasing shareholder value. The Company's current plan provides for the issuance of unrestricted stock awards upon reaching levels of return on equity, as calculated above, at levels at or in excess of 10%. Upon attainment of return on equity of 10%, the Compensation Committee will award the Senior Executives a pool of up to 25,000 shares of unrestricted stock awards. The Named Executive Officer, upon grant, will be entitled to all rights and voting privileges associated with such stock grant and will be responsible for the payment of all applicable taxes associated therewith.

#### Discretionary Stock Awards:

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We believe that management should be rewarded for outstanding performance, irrespective of financial targets and metrics and therefore reserve the right to issue unrestricted stock grants to Named Executive Officers and other individuals at our discretion. In 2006, the Board of Directors, upon

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recommendation by the Compensation Committee, awarded 11,700 shares to the Named Executive Officers and certain other senior management in conjunction with this discretionary stock award.

The following table summarizes the Stock Awards issued to Named Executives in 2007 as they related to the 2006 fiscal year:

<u>Name</u>	<u>Shares</u>	<u>Market Price</u>	<u>Total</u>
Paul E. Hassler	5,000	\$11.81	\$59,050
Andy L. Nemeth	2,500	\$11.81	29,525
Gregory J. Scharnott	1,750	\$11.81	20,668

### Stock-Based Compensation:

Beginning in 2006, the Company granted the Named Executive Officers the right to elect to receive any or all of their base pay increases in any given year in restricted stock in lieu of cash. The election is made as of the first of the year. The shares are issued as of the first of the year and vest quarterly at 25% per quarter. The officers are responsible for all applicable taxes associated with such shares and are entitled to all rights and voting privileges with respect to such shares.

The following table summarizes the individual elections in 2006 made by the Named Executive Officers to have shares issued in lieu of cash compensation:

<u>Name</u>	<u>Shares</u>	<u>Market Price (1)</u>	<u>Total</u>
Paul E. Hassler	3,780	Various	\$45,436
Andy L. Nemeth	1,890	Various	22,718
Gregory J. Scharnott	1,890	Various	22,718

(1) The market prices of the stock grants were based on the closing stock price on the last day of each fiscal quarter.

### **Non-Qualified Stock Options**

Beginning in 2006, the Company began using performance shares in lieu of stock options as the primary incentive for the Named Executive Officers due to the regulatory reporting requirements and the preference towards stock awards as a primary form of long term incentive compensation. The Compensation Committee has not granted any stock options to the Named Executive Officers since 2005. At December 31, 2006, the Company currently has three (3) non-qualified stock option grants outstanding with grant dates, vesting dates, percent exercisable, and termination dates as follows:

<u>Grant Date</u>	<u>Options Remaining</u>	<u>Vested</u>	<u>Unvested</u>	<u>Termination Date</u>
11/1/01	24,375	100%	0%	10/31/07
6/22/04	106,375	50%	50%	6/21/10
10/31/05	68,500	25%	75%	10/30/11

A description of all stock awards held by the Named Executives as of the end of fiscal 2006 is contained in the Outstanding Equity Awards at Fiscal Year End table on page 14.

We reserve the right at any time to grant options under its stock option plan.

**Executive Retirement Plan**

The Company maintains a non-qualified executive retirement plan for its key executives. Under the plan and upon vesting, the employee is entitled to receive upon the attainment of age 65, 40% of the

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employee's annual base wages paid over ten years in 520 consecutive weekly payments. The employee may retire at any time upon achieving age 60 and prior to age 65 with a 5% penalty per year. Each employee invited to participate in the plan is approved by the Board of Directors. The employee makes no contributions to the plan and the retirement benefits are unfunded. The Company purchases and is the owner of life insurance policies on certain executives which accumulate cash value as a potential source of funding, if required. The benefits under the plan are unsecured and subject to substantial risk in the event of bankruptcy or other insolvency matters. These benefits are not taxable to the employee until received and vest upon a change in control, the employee achieving 25 years of continuous service, the employee reaching age 65, or a combination of the employee's age and years of service equaling 85. The provisions of the agreement provide for benefits payable in the event of death or disability. All Named Executive Officers are participants in this plan.

### **Perquisites**

We believe in a performance based compensation and benefits package and therefore provide very few perquisites to our named executives. We do not provide the personal use of a company airplane or a company car or other transportation, nor does the Company provide security at a personal residence, commuting expenses, personal travel using vehicles owned or leased by the Company, housing and other living expenses, clerical or secretarial services for personal matters, club memberships not exclusively used for business memberships, personal financial or tax advice or investment management services, or tax planning, financial planning, or tax preparation costs. We provide a car allowance to our named executives, corporate managers, and general managers, all of which are included as taxable income.

### **Benefit Plans**

We do not maintain separate benefit plans for our Named Executive Officers. They participate in the same health and welfare plans as all of our other general employees with the same deductibles and co-pays. The Named Executive Officers also participate in the same 401(k) retirement program as all of the other general employees.

**Summary Compensation Table**

The following Summary Compensation Table sets forth information about the compensation paid to our Chief Executive Officer, our Chief Financial Officer and any other highly compensated executive officers who were required to file reports under section 16 of the Securities Exchange Act of 1934 (the "Named Executive Officers") for the year ended December 31, 2006:

Name and Principal Position	Year	Salary (\$)(1)	Bonus (\$)(2)	Stock Awards (\$)(3)	Option Awards (\$)(4)	Non-Equity Incentive Plan Compensation (5)	Change in Pension Value and Nonqualified Deferred	All Other	Total (\$)
							Earnings (\$)(6)		
Paul E. Hassler	2006	\$280,020	-	\$99,080	\$40,241	\$66,560	\$82,123	\$14,144 (7)	\$582,168
President and Chief Executive Officer Andy L. Nemeth	2006	180,024	-	49,540	23,816	41,600	6,316	14,032 (8)	315,328
Executive Vice President of Finance, Secretary-Treasurer, and Chief Financial Officer Gregory J. Scharnott	2006	180,024	-	40,683	23,816	41,600	36,432	14,032 (8)	336,587
Executive Vice President of Operations and Distribution									

- (1) 2006 base salaries which took effect on January 1, 2006 were as follows: Mr. Hassler, \$320,000, Mr. Nemeth, \$200,000, Mr. Scharnott, \$200,000. Effective January 1, 2007, Mr. Hassler's base salary was increased to \$335,000 and Mr. Nemeth's base salary was increased to \$217,000. Mr. Scharnott resigned effective March 12, 2007.
- (2) The named executives were not entitled to receive any payments that would be characterized as Bonus payments for the fiscal year ended December 31, 2006. Amounts listed under the column Non-Equity Incentive Plan Compensation constitutes Annual Incentive Plan awards for 2006 performance that were approved by the Compensation Committee on February 23, 2007, and paid shortly thereafter.
- (3) Represents (i) the dollar amount of optional salary deferrals in the form of stock awards that each named executive elects to receive in lieu of cash compensation at the beginning of the fiscal year. These stock awards are awarded at the beginning of the year and vest 25% per quarter. The named executive is responsible for all income taxes and other costs associated with the awards. In 2006, Mr. Hassler elected to receive \$40,030 of his annual base compensation in the form of Company common stock and Mr. Nemeth and Mr. Scharnott each elected to receive \$20,015 of their annual base compensation in the form of Company common stock, and (ii) the dollar amount associated with a discretionary grant of shares by the Compensation Committee of the Board of Directors associated with the 2006 Annual Incentive Plan. Under the Plan, the Compensation Committee may award a discretionary bonus in the form of stock to the named executives. In 2007, the Compensation Committee granted 5,000 shares to Mr. Hassler, 2,500 shares to Mr. Nemeth, and 1,750 shares to Mr. Scharnott. These shares were granted at the share price on the date of grant of \$11.81 per share and accordingly, in 2007, the Company recognized \$59,050 in compensation expense for Mr. Hassler, \$29,525 for Mr. Nemeth, and \$20,668 for Mr. Scharnott.
- (4) Represents the dollar amount associated with the named executive's option grants that are recognized as compensation for financial statement reporting purposes with respect to fiscal 2006 in accordance with FAS 123(R). For a discussion of the assumptions made in the valuation, please see Note 9 (Stock Option Plan) to the financial statements in our Annual Report on Form 10-K under the heading Compensation Plans. Includes 2006 compensation expense associated with stock options granted in 2004 and 2005.
- (5) Represents 2006 amounts paid in 2007 under the Annual Non-Equity Incentive Plan.



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- (6) Represents the aggregate change in the present value of the named executive's accumulated benefit under the Patrick Industries, Inc. Executive Retirement Plan. In computing these amounts, the Company uses various assumptions including remaining years of service, estimated discount rates, and present value calculations. None of the Named Executive Officers were vested in this plan at December 31, 2006.
- (7) Represents \$13,440 in car allowance and \$704 in company contributions pursuant to the Patrick Industries, Inc. 401(k) Plan.
- (8) Represents \$13,440 in car allowance and \$592 in company contributions pursuant to the Patrick Industries, Inc. 401(k) Plan.

The compensation represented by the amounts for the year ended December 31, 2006 set forth in the All Other Compensation column in the Summary Compensation Table for the Named Executive Officers detailed in the table below.

<u>Name and Principal Position</u>	<b>Company Contributions</b>				
	<b>to Retirement</b>				
	<u>Qualified Savings Plan</u>	<u>Group Term Life Insurance</u>	<u>Benefit Plan</u>	<u>Automobile Allowance</u>	<u>Other</u>
Paul E. Hassler President and Chief Executive Officer	-	-	\$704	\$13,440	-
Andy L. Nemeth Executive Vice President of Finance, Secretary-Treasurer, and Chief Financial Officer	-	-	592	13,440	-
Gregory J. Scharnott Executive Vice President of Operations and Distribution	-	-	592	13,440	-

**Options Granted in Last Fiscal Year**

No options were granted in 2006. See Non-Qualified Stock Options under the heading Compensation Discussion and Analysis for details on outstanding stock option grants.

**Outstanding Equity Awards at December 31, 2006**

The following table summarizes the outstanding equity awards held by the named executives as of December 31, 2006:

(1) Stock options within each annual grant vest incrementally at a rate of 25% per year, with full vesting at the end of four years, and expire after six years.

**Grants of Plan-Based Awards**

The table below sets forth information on grants to the named executives of options and stock awards as set forth in the Stock Awards section of the Summary Compensation Table in 2006:

		Estimated Future Payouts			Estimated Future Payouts			All Other	All Other	Exercise
		Under Non-Equity			Under Equity					
<u>Name</u>	<u>Grant Date</u>	<u>Incentive Plan Awards</u>			<u>Incentive Plan Awards</u>			or Units	Underlying Options	Option Awards
		<u>Threshold</u>	<u>Target</u>	<u>Maximum</u>	<u>Threshold</u>	<u>Target</u>	<u>Maximum</u>			
		<u>(\$)</u>	<u>(\$)</u>	<u>(\$)</u>	<u>(#)</u>	<u>(#)</u>	<u>(#)</u>	<u>(#)</u>	<u>(#)</u>	<u>(\$/Sh)</u>
					-					
Paul E. Hassler	1/2/06	\$0	\$0	\$0	0	3,780	3,780	0	0	\$0
	2/16/07	0	0	0	0	5,000	5,000	0	0	0
Andy L. Nemeth	1/2/06	0	0	0	0	1,890	1,890	0	0	0

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	2/16/07	0	0	0	0	2,500	2,500	0	0	0
Gregory J. Scharnott	1/2/06	0	0	0	0	1,890	1,890	0	0	0
	2/16/07	0	0	0	0	1,750	1,750	0	0	0

**Option Exercises and Stock Vested**

The following table sets forth information about stock options exercised by the named executives in 2006 and stock awards that vested or were paid in 2006 to the named executives. This information is set forth in the Summary Compensation Table:

<u>Name</u>	<u>Option Awards</u>		<u>Stock Awards</u>	
	<u>Number of Shares Acquired on Exercise (#)</u>	<u>Value Realized on Exercise (\$)</u>	<u>Number of Shares Acquired on Vesting (#)</u>	<u>Value Realized on Vesting (\$) (2)</u>
Paul E. Hassler	-	-	3,780 (1)	\$45,436 (2)
	-	-	5,000 (3)	59,050 (4)
Andy L. Nemeth	-	-	1,890 (1)	22,718 (2)
	-	-	2,500 (3)	29,525 (4)
Gregory J. Scharnott	-	-	1,890 (1)	22,718 (2)
	-	-	1,750 (3)	20,668 (4)

- (1) Represents Officer elected deferrals of 2006 base wages in the form of Company common stock which vests over a period of one year on a quarterly basis.
- (2) Based on a vesting schedule of 25% per quarter with closing share prices of \$11.87, \$11.27, \$12.44, and \$12.50.
- (3) Represents discretionary stock grant awarded to named executives on February 16, 2007 by the Board of Directors in conjunction with 2006 performance.
- (4) Based on immediate vesting on February 16, 2007 at a closing share price of \$11.81.

**Equity Compensation Plan Information**

(a)	(b)	(c)
Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted average exercise price of outstanding options, warrants, and rights	Number of securities remaining for future issuance under equity compensation plans (excluding securities reflected in column (a))

Plan Category  
Equity compensation plans approved by security holders

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Equity compensation plans not approved by security holders	199,250	\$9.54	728,158
	0	N/A	0
Total	199,250	\$9.54	728,158

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**Nonqualified Defined Contribution and Other Deferred Compensation Plans**

The following table sets forth information about the participation of the named executives in the Executive Retirement Program and is set forth in the Summary Compensation Table under the caption Change in Pension Value and Nonqualified Deferred Compensation Earnings:

<u>Name</u>	<u>Executive Contributions in last FY (\$)</u>	<u>Registrant Contributions in last FY (\$)</u>	<u>Aggregate Earnings in last FY (\$)</u>	<u>Aggregate Withdrawals/ Distributions (\$)</u>	<u>Aggregate Balance at Last FYE (\$)</u>
Paul E. Hassler	-	\$68,941	\$13,182	-	\$270,444
Andy L. Nemeth	-	5,598	718	-	16,571
Gregory J. Scharnott	-	32,336	4,096	-	94,950

The Patrick Industries, Inc. Executive Retirement Plan is a non-qualified unfunded plan awarded to certain named executives by the Board of Directors. As a participant in the Plan, the Company will pay each of the Named Executive Officers, or their beneficiaries, up to 40% of their base salary for 120 months upon retirement (if the employee continues in the employment of the Company until the age of 65, or upon the attainment of other parameters), or upon the employee's death or total disability. A participant vests after 30 years of continuous service, or upon a combination of the years of service plus the employee's age equaling 85. Additionally, the named executives vest upon a change of control event in which a party acquires 33% or more of the Company's outstanding common stock. The Company has a life insurance contract on each named individual as a potential funding source for payments under the obligations; however, the benefits are subject to risk in the event of bankruptcy or certain other events.

**Employment Contracts**

The Company entered into Employment Agreements with Paul E. Hassler, Andy L. Nemeth, and Gregory J. Scharnott, pursuant to which they agreed to serve as executive officers of the Company. The Agreements contain a non-compete clause and certain other stipulations and provide for a severance package that includes twelve (12) months base salary for Paul E. Hassler and six (6) months base salary for Andy L. Nemeth and Gregory J. Scharnott. Under the Agreements, voluntary termination with or without good reason, death, disability or retirement, shall not result in any obligation of the Company to make payments.

**Potential Payments Upon Termination and Following a Change in Control for Fiscal Year 2006**

We believe that the Company should provide reasonable severance benefits to our Named Executive Officers and other general employees that are fair and commensurate with their job duties, functions, and responsibilities. We believe it is important to protect our key employees in the event of a change in control and it is also in the best interest of the Company to obtain a release from employees whose employment is terminated as well as a non-compete agreement from certain employees in the form of a severance agreement. The following table summarizes the severance agreements at December 31, 2006 for our Named Executives in the event they are terminated without cause:

**Payments upon**

**Termination**

**Confidentiality**

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<b>Name</b>	<b>Severance</b>	<b>Without Cause (1)</b>	<b>Non Compete</b>	<b>Agreement</b>
Paul E. Hassler	12 Months Base Salary	\$320,000	1 Year	1 Year
Andy L. Nemeth	6 Months Base Salary	100,000	1 Year	1 Year
Gregory J. Scharnott	6 Months Base Salary	100,000	1 Year	1 Year

(1) Employee is required to sign a mutual release of claims in a form satisfactory to the Company.

**Director Compensation**

Non-employee directors are paid an annual retainer of \$5,000, \$1,000 for each board meeting and conference call they attend, and \$1,000 for each committee meeting they attend with a maximum of \$2,000 per combined event. Committee members receive an additional annual retainer of \$5,000, regardless of the number of committees on which they serve, and effective for fiscal 2007, Committee chairmen receive an additional \$2,000 annual retainer. The lead director receives an additional annual retainer of \$5,000. Employee directors receive no compensation as such. On an annual basis in May, each non-employee director is automatically granted a restricted stock award for 3,000 shares of the Company's common stock which will vest upon such director's continued service as a member of the Board of Directors for one year or earlier upon certain events. Effective for fiscal 2007, non-employee directors will receive an annual share grant of 3,500 shares.

The following table sets forth a summary of the compensation we paid to our non-employee directors in the year ended December 31, 2006:

<b>Name</b>	<b>Fees Earned or Paid in Cash (\$)(1)</b>	<b>Stock Awards (\$)(2)</b>	<b>Option Awards (\$)</b>	<b>Non-Equity Incentive Plan Compensation (\$)</b>	<b>Changes in Pension Value and Nonqualified Deferred Compensation Earnings (\$)</b>	<b>All Other Compensation</b>	
						<b>(\$)</b>	<b>Total (\$)</b>
Terrence D. Brennan	\$ 17,000	\$ 38,280	---	---	---	---	\$ 55,280
Keith V. Kankel	12,000	38,280	---	---	---	---	50,280
John H. McDermott	18,000	38,280	---	---	---	---	56,280
Larry D. Renbarger	19,000	38,280	---	---	---	---	57,280
Robert C. Timmins	24,000	38,280	---	---	---	---	62,280
Walter E. Wells	19,000	38,280	---	---	---	---	57,280
Harold E. Wyland	17,000	38,280	---	---	---	---	55,280

(1) The amounts under the column headed "Fees Earned or Paid in Cash" represent meeting and retainer fees.

(2) Represents the value of 3,000 shares of restricted stock granted to each non-employee director at a closing stock price of \$12.76 on May 11, 2006.

## COMPENSATION COMMITTEE REPORT

The Compensation Committee of the Company has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

The Compensation Committee

Terrence D. Brennan (Chairman)  
John H. McDermott  
Larry D. Renbarger  
Robert C. Timmins  
Walter E. Wells  
Harold E. Wyland

## COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During 2006, no executive officer of the Company served on the Board of Directors or compensation committee of any other corporation with respect to which any member of the Compensation Committee was engaged as an executive officer. No member of the Compensation Committee was an officer or employee of the Company during 2006, and no member of the Compensation Committee was formerly an officer of the Company.

## HOUSEHOLDING OF PROXY MATERIALS

Some banks, brokers, and other nominee record holders may be participating in the practice of householding proxy statements and annual reports. This means that only one copy of this Notice of Special Meeting and Proxy Statement may have been sent to multiple shareholders in your household. If you would prefer to receive separate copies of a proxy statement either now or in the future, please contact your bank, broker, or other nominee. Upon written or oral request to Andy L. Nemeth at 107 West Franklin Street, P.O. Box 638, Elkhart, Indiana, 46515-0638, we will provide a separate copy of the Annual Report for the year ended December 31, 2006 or Notice of Annual Meeting and Proxy Statement.

## SHAREHOLDER PROPOSALS

Shareholder proposals for inclusion in proxy materials for the next Annual Meeting should be addressed to the Company's Secretary, P.O. Box 638, Elkhart, Indiana 46515-0638, and must be received no later than Friday, December 7, 2007. In addition, the Company's Bylaws require notice of any other business to be brought before a meeting by a shareholder (but not included in the proxy statement) to be delivered, in writing, to the Company's Secretary, together with certain prescribed information, not less than 90 days nor more than 110 days prior to the first anniversary of the preceding year's annual meeting. Likewise, the Articles of Incorporation and Bylaws require that shareholder nominations to the Board of Directors be delivered to the Secretary, together with certain prescribed information in accordance with the procedures for bringing business before an Annual Meeting at which directors are to be elected.

## INCORPORATION BY REFERENCE

The Company incorporates by reference in this Proxy Statement the following from its Annual Report on Form 10-K for the year ended December 31, 2006: Part II, Item 7 (Management's Discussion



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and Analysis of Financial Condition and Results of Operations), Item 7A (Quantitative and Qualitative Information About Market Risk), Item 8 (Financial Statements and Supplementary Data) and Item 9 (Changes in and Disagreements with Accountants on Accounting and Financial Disclosure). The Company also incorporates by reference in this Proxy Statement the financial statements set forth as Ex. 99.1, Ex. 99.2, and Ex. 99.3 to Form 8-K/A as filed with the Securities and Exchange Commission on July 3, 2007.

### **OTHER MATTERS**

A copy of the documents described in the section entitled "Incorporation By Reference" may be obtained without charge by writing to Andy L. Nemeth, Patrick Industries, Inc., P.O. Box 638, Elkhart, Indiana 46515-0638.

The Board of Directors knows of no other proposals which may be presented for action at the Special Meeting. However, if any other proposal properly comes before the meeting, the persons named in the proxy form enclosed will vote in accordance with their judgment upon such matter. Representatives of the Company's independent auditor, McGladrey & Pullen, LLP, are expected to be present at the special meeting.

**Shareholders are urged to promptly vote by telephone, by Internet, or execute and return the enclosed form of proxy in the envelope provided.**

By Order of the Board of Directors,

ANDY L. NEMETH

SECRETARY

\_\_\_\_\_, 2007

c/o National City Bank

Shareholder Services Operations

Locator 5352

P. O. Box 94509

Cleveland, OH 44101-4509

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**VOTE BY TELEPHONE**

Have your proxy card available when you call the **Toll-Free Number 1-888-693-8683** using a touch-tone phone and follow the simple instructions to record your vote.

**VOTE BY INTERNET**

Have your proxy card available when you access the website **www.cesvote.com** and follow the simple instructions presented to record your vote.

**VOTE BY MAIL**

Please mark, sign and date your proxy card and return it in the **postage-paid envelope** provided or return to: National City Bank, P.O. Box 535300, Pittsburgh, PA 15253.

**Vote by Telephone**

Call **Toll-Free** using a Touch-Tone phone:

**888-693-8683**

**Vote 24 hours a day, 7 days a week!**

**Vote by Internet**

Access the **website** and cast your vote:  
**www.cesvote.com**

**Vote by Mail**

Return your proxy

in the **postage-paid** envelope provided.

**If you vote by telephone or Internet, please do not send your proxy by mail.**

**If voting by mail, Proxy must be signed and dated below.**

**Please fold and detach card at perforation before mailing.**

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**This Proxy when properly executed will be voted in the manner directed herein by the undersigned shareholders. If no specific direction is made, this proxy will be voted in accordance with the recommendations of the Board of Directors.**

**Your signature on this proxy is your acknowledgment of receipt of the Notice of Meeting and Proxy Statement.**

Dated: \_\_\_\_\_, 2007

Signature

(Signature if held jointly)

Please sign exactly as name appears hereon. For joint accounts, all tenants must sign. Executors, Administrators, Trustee, etc. should so indicate when signing.

**PLEASE MARK, SIGN, DATE, AND RETURN THE PROXY CARD PROMPTLY USING THE ENCLOSED ENVELOPE.**

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**YOUR VOTE IS IMPORTANT**

Regardless of whether you plan to attend the Special Meeting of Shareholders, you can be sure your shares are represented at the meeting by promptly returning your proxy in the enclosed

Please fold and detach card at perforation before mailing.

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patrick industries, inc.

107 West Franklin Street, P.O. Box 638,  
Elkhart, Indiana 46515

**This Proxy is Being Solicited on Behalf of the Board of Directors**

The undersigned hereby appoints Paul E. Hassler and Andy L. Nemeth, and each of them, as the undersigned's proxies, each with full power of substitution, to represent and to vote, as designated below, all of the undersigned's Common Stock in Patrick Industries, Inc. at the Special Meeting of Shareholders of Patrick Industries, Inc. to be held on Thursday, October 25, 2007, and at any adjournment thereof, with the same authority as if the undersigned were personally present.

**The Board of Directors recommends a vote FOR proposals 1, 2, 3 and 4 below:**

1. To approve a rights offering granting shareholders one right to purchase 0.2 of a share of common stock, for each share of the Company's common stock they own, at a purchase price of \$11.25 per share, or an aggregate of approximately 1,200,000 shares of common stock for an aggregate purchase price of approximately \$13,500,000.  
 **FOR**                                       **AGAINST**                                       **ABSTAIN**
2. To approve the Standby Purchase Agreement and the transactions contemplated thereunder, pursuant to which Tontine Capital Partners, L.P. and Tontine Capital Overseas Master Fund, L.P. (collectively, Tontine) have committed to purchase at \$11.25 per share, any shares not purchased in the rights offering.  
 **FOR**                                       **AGAINST**                                       **ABSTAIN**
3. To approve the sale of up to 130,000 shares of common stock to certain management employees at \$11.25 per share, or an aggregate purchase price of up to \$1,462,500.  
 **FOR**                                       **AGAINST**                                       **ABSTAIN**
4. To amend our Articles of Incorporation to increase the number of authorized shares of common stock, without par value, from 12,000,000 to 20,000,000 and the aggregate number of shares of capital stock to 21,000,000.  
 **FOR**                                       **AGAINST**                                       **ABSTAIN**
5. To consider and transact such other business as may properly come before the meeting or any adjournments thereof.