

Corporate Resource Services

(CRRS-NASDAQ)

CRRS: Company Working to Achieve Compliance; 2013 Results Illustrate Some Improvements in Cost Structure, with More Anticipated

OUTLOOK

Corporate Resource Services (CRS), a rapidly growing temporary staffing company with an ambitious M&A strategy, is focused on margin improvements through diversification efforts, shifting its product and service mix and acquiring higher margin businesses. We are enthusiastic about the company's growth prospects and believe the favorable outlook for the temporary staffing industry provides a positive tailwind.

Current Recommendation	Hold
Prior Recommendation	Buy
Date of Last Change	6/04/2014
Current Price (07/18/14)	\$2.17
Six- Month Target Price	\$2.90

SUMMARY DATA

52-Week High	\$5.62
52-Week Low	\$1.91
One-Year Return (%)	-35
Beta	0.55
Average Daily Volume (sh)	153,968

Shares Outstanding (mil)	159
Market Capitalization (\$mil)	\$345
Short Interest Ratio (days)	1.50
Institutional Ownership (%)	0
Insider Ownership (%)	93

Annual Cash Dividend	\$0.00
Dividend Yield (%)	0.00

5-Yr. Historical Growth Rates	
Sales (%)	78.0
Earnings Per Share (%)	N/A
Dividend (%)	N/A

P/E using 2013 Actual	108.5
P/E using 2014 Estimate	13.6
P/E using 2015 Estimate	9.9

Zacks Rank	3
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Risk Level	Above Average
Type of Stock	Small-Growth
Industry	Business Svcs
Zacks Rank in Industry	N/A

ZACKS ESTIMATES

Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)*
2012	145 A	154 A	180 A	201 A	680 A
2013	194 A	199 A	209 A	217 A	820 A
2014	233 E	243 E	255 E	269 E	1,000 E
2015					1,200 E

Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2012	-\$0.02 A	-\$0.01 A	\$0.01 A	\$0.01 A	-\$0.01 A
2013	\$0.00 A	\$0.01 A	\$0.03 A	-\$0.02 A	\$0.02 A
2014	\$0.04 E	\$0.04 E	\$0.04 E	\$0.04 E	\$0.16 E
2015					\$0.22 E

Disclosures begin page 9

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

*FY end has changed to Dec.in 2013 Disclosures pg 9

KEY POINTS

- On June 23, 2014, CRS submitted a plan to the Nasdaq to regain listing compliance. Subsequently, on July 1, 2014, the company filed its FY 2013 10K.
- On July 9, 2014, Nasdaq granted CRS an extension to submit its first quarter 2014 10Q and other potentially late filings by September 29, 2014. If the company does not meet that deadline, CRRS shares could be delisted from the Nasdaq. **Management expects to file the 1Q14 10Q by the deadline.**
- For fiscal year (FY) 2013, revenue increased 20.6% year-over-year to \$819.7 million, reflecting 16.4% organic growth and the contribution from newly acquired companies. **The company's guidance for 2014 is for revenue greater than \$1 billion.**
- FY 2013 results illustrated some cost structure improvements but management expects more to come. The company was able to lower the fee that it pays to affiliated company Tri-State for providing certain PEO administrative services from 2.0% to 1.4%. Management believes there may be further opportunities to lower this administrative fee. Overall, CRS reported positive net income of \$2.776 million and EPS of \$0.02 for FY 2013.
- During FY 2013, the company identified certain errors in its historical accounting. As a result, CRS restated the relevant FY 2013 quarters. The company also changed its accounting firm to Crowe Horwath, which management believes will lead to better controls over its accounting and financial reporting.
- On June 27, 2014, CRRS shares were added to several Russell Indices. Trading volume jumped from 162,400 to 1,766,700 on June 27, with the 30-day average remaining above the level before the inclusion in the Russell indices.
- We believe risks include that the shares are delisted from Nasdaq if CRS does not meet the deadline, that EPS could be lumpy over the next several quarters, competition could increase, the industry could be hurt by changing economic factors and that CRS is essentially a controlled company.

COMPANY HAS SUBMITTED PLAN TO REGAIN COMPLIANCE

Nasdaq Grants an Extension

CRS submitted a plan to the Nasdaq to regain listing compliance on June 23, 2014. Subsequently, on July 1, 2014, the company filed its FY 2013 10K.

On July 9, 2014, CRS received notice from Nasdaq that it was still non-compliant because it had not filed its 1Q FY 2014 10Q. However, Nasdaq granted an exception so that CRS could regain compliance if it files by September 29, 2014. If the company does not file its financial statements by then, CRRS shares could be delisted from the Nasdaq. **Management expects to meet the deadline.**

2013 HIGHLIGHTS

Some Cost Structure Improvements But Expect More to Come

For fiscal year (FY) 2013, CRS's revenue increased 20.6% year-over-year to \$819.7 million, partly reflecting the impact of M&A transactions. Newly acquired staffing companies contributed \$28.7 million in revenues in FY2013 which, combined with 16.4% organic growth in revenues, helped the company achieve the above noted annual improvement. **The company's guidance for 2014 is for revenue greater than \$1 billion.** We have updated our forecast to reflect recent trends and guidance.

The company's strategy has been to eliminate unprofitable accounts in order to improve its efficiency and overall margins. CRS pursued this strategy over FY 2013. The company's direct costs increased 20.6% in FY 2013 to \$723.3 million, although as a percentage of revenues it remained flat at 88.2%. The elimination of certain unprofitable accounts also eliminated the direct costs associated with those accounts. These declines were partially offset by increased state unemployment tax rates in certain markets where the company has sizable operations.

CRS's FY 2013 gross profit improved 20.4% versus FY 2012 to \$96.4 million. Gross margin of 11.8% was flat with FY 2012. The company continues to implement measures to expand gross margins, including **diversifying its service offerings, improving its pricing structure and managing unemployment claims to reduce state unemployment taxes.** Management expects these initiatives to contribute to gross margin improvement over time. FY 2013 margins were also negatively impacted by CRS's growth in the lower margin light industrial businesses. The company is working to shift its product and service mix to higher margin services.

Importantly, we believe, in 2013 the company was also able to lower the fee that it pays to Tri-State, the affiliated company that provides certain PEO (Professional Employer Organization) administrative services to CRS, including payroll services, workers' compensation coverage and payroll tax and employee benefit plan administration. This fee fell to 1.4% from 2.0% and CRS believes there may be opportunities to lower it further. CRS accounted for 37.5% of Tri-State's aggregate administrative fee revenue in 2013.

FY 2013 S,G&A expenses rose 12.4% versus FY 2012 to \$83.7 million. As a percentage of revenue, S,G&A expenses were down slightly to 10.2% from 10.9% in FY 2012. The company was able to contain costs somewhat, as a result of consolidation of select offices and administrative functions. CRS reported positive net income of \$2.766 million and EPS of \$0.02 for FY 2013.

WORKING TO STRENGTHEN FINANCIAL CONTROLS

During the FY 2013, the company identified certain errors in its historical accounting for:

- factoring of receivables to Wells Fargo, which led to an understatement of assets and liabilities in its third quarter FY 2013 and year-end FY 2012 balance sheets, but had no impact on its P&L;
- stock-based compensation expense, which understated S,G&A expense for the first nine months of FY 2013 and FY 2012 by roughly \$3.3 million and \$0.2 million, respectively.
- deferred taxes, which understated liabilities in 3Q FY 2013 and year-end 2012 balance sheets by \$1.1 million and \$0.9 million, respectively, and deferred income tax provision for the first nine months of FY 2013 and FY 2012 by approximately \$0.2 million and \$0.3 million, respectively.

- Certain balance sheet items, which understated assets by \$0.5 million and \$0.7 million, respectively, in the 3Q FY 2013 and year-end FY 2012 balance sheets and overstated operating and net income for the first nine months and full year of FY 2013 by \$0.1 million and \$0.2 million, respectively and of FY 2012 by \$0.7 million and \$0.4 million, respectively.

As a result, CRS restated the relevant FY 2013 quarters. The restatements had no impact on revenue. We estimate the impact on FY 2012 and FY 2013 net income at about \$104,000 and nearly \$4 million, respectively. The above noted positive net income of \$2.776 million for FY 2013 is pro forma including the revisions. The company also changed its accounting firm to Crowe Horwath LLP, which management believes will lead to better controls over its accounting and financial reporting. Crowe Horwath operates offices throughout the country and has been in public accounting for over 70-years.

Separately, CRS also determined that it should account for its retail energy joint venture Abest Power & Gas as an equity investment going forward.

ACQUISITIONS

The company continues to pursue smaller tuck-in acquisitions on the staffing side. To-date in 2014, CRS has purchased two staffing companies: Staff Management Group and Alar Staffing. Combined, these acquisitions add roughly \$115 million in annual revenue. They mark the seventh and eight major acquisitions of regional staffing agencies that CRS has made since 2009. CRS has aggregated these smaller companies under one umbrella operating under or co-branded with the CRS brand.

The purchase of New Jersey based Staff Management Group added some \$85+ million in annual revenue and also strengthened the company's position in the New Jersey staffing sector. Management believes that with Staff Management Group, **CRS has become the leading staffing provider in the state of New Jersey.** In turn, we would expect this to lead to greater opportunities for higher margin contracts.

Separately, in March 2014, the company purchased New York based Nationwide Screening Services. Management expects Nationwide to help CRS consolidated gross margins, as the screening company generates gross margins north of 65%. Moreover, the company anticipates that it can achieve significant synergies by adding a firm that screens job applicants to its core business of providing temporary staffing services.

<i>Date</i>	<i>Acquisition</i>	<i>Price Paid</i>	<i>Rev (\$M)</i>	<i>Multiple</i>
Apr 2010	GT Systems	\$3M	NA	NA
Aug 2010	Tri-Overload Staffing*	\$6.2M in stock	\$27	0.2x
Dec 2010	Integrated Consulting Group	Assumption of debt	NA	NA
Jan 2011	Tri-Diamond Staffing*	\$25M in stock	\$100	0.3x
April 2011	Cameo Personnel Systems	\$750,000	\$12	0.1x
Nov 2011	TS Staffing Services*	\$30M in stock	\$180	0.2x
2013	Summit Software*	\$13.75 in stock	\$2.5	5.5x
2013	Personally Yours, Inc.	NA	NA	NA
2013	Personnel Solutions, Inc.	NA	NA	NA
Nov 2013	Flex Recruitment Plus	NA	NA	NA
Feb 2014	Staff Management Group	\$10M	\$85	0.1x
Feb 2014	Alar Staffing	\$5M	\$30	0.2x

*Related transaction

Source: Company reports, Zacks Small Cap Research

RECENT NEWS

- On June 23, 2014, CRS submitted its compliance plan to Nasdaq to regain listing compliance.
- The company filed its FY 2013 10-K on July 1, 2014.
- Nasdaq notified management on July 9, 2014 that it must file all delinquent financial reports by September 29, 2014 to regain compliance. The company is working to become compliant by the deadline.
- CRS amended its agreement with Wells Fargo on June 20, 2014, extending terms through June 30, 2015. The Wells Fargo agreement provides for up to \$80.0 million in financing of receivables at LIBOR + 4.25% - 6.17%. Management hopes to replace this with a line of credit before the Wells Fargo agreement ends on June 20, 2015.
- On June 27, 2014, CRRS shares were added to the Russell Microcap, Russell 3000 and Russell Global indices. Trading volume in CRRS shares jumped from 162,400 to 1,766,700 on June 27.

RISKS

- We believe the company faces the risk that its shares are delisted from Nasdaq if it cannot file its 10Q on time.
- The company recently began to convert strong revenue expansion into positive EPS. Quarterly EPS could be lumpy over the next several quarters.
- Competition could increase. The temporary staffing industry is one with few barriers to entry, we believe.
- Customers could shift towards hiring permanent employees instead of using temporary workers.
- Economic factors could constrain industry growth.
- The industry is populated heavily with mom & pops. As other, larger players acquire smaller operations, it could drive up costs of future acquisitions for CRS.
- The company's diversification efforts with Summit Software and Abest might take longer than expected or not be successful.
- **We believe among the biggest risks is that CRS is essentially a controlled company, with significant related party transactions, and insider interests could conflict with those of outside shareholders.**

INSIDER TRADING AND OWNERSHIP

In 2009, privately-held Tri-State Employment Services gained control of CRS. Robert Cassera, a member of the company's board, owns Tri-State Employment Services and beneficially owns roughly 90% of CRS shares. Other insiders, including the management team, hold another 2.5%, for total insider holdings of about 92.5%. This sizable insider ownership is a double edged sword, in our view. On the one hand, management's investment in the company creates strong interest in driving growth and share price appreciation, in our view. On the other hand, it also makes the shares highly illiquid and therefore difficult for outside investors to accumulate any meaningful stake.

We would expect insiders to reduce their holdings over time to enable outside investors to participate. CRS shares moved from the OTC market to the Nasdaq on September 6, 2013, which could also enhance the company's trading liquidity over time, in our view, as more shares enter the free float. We believe their inclusion in the Russell indices could also provide a sustainable improvement to trading liquidity.

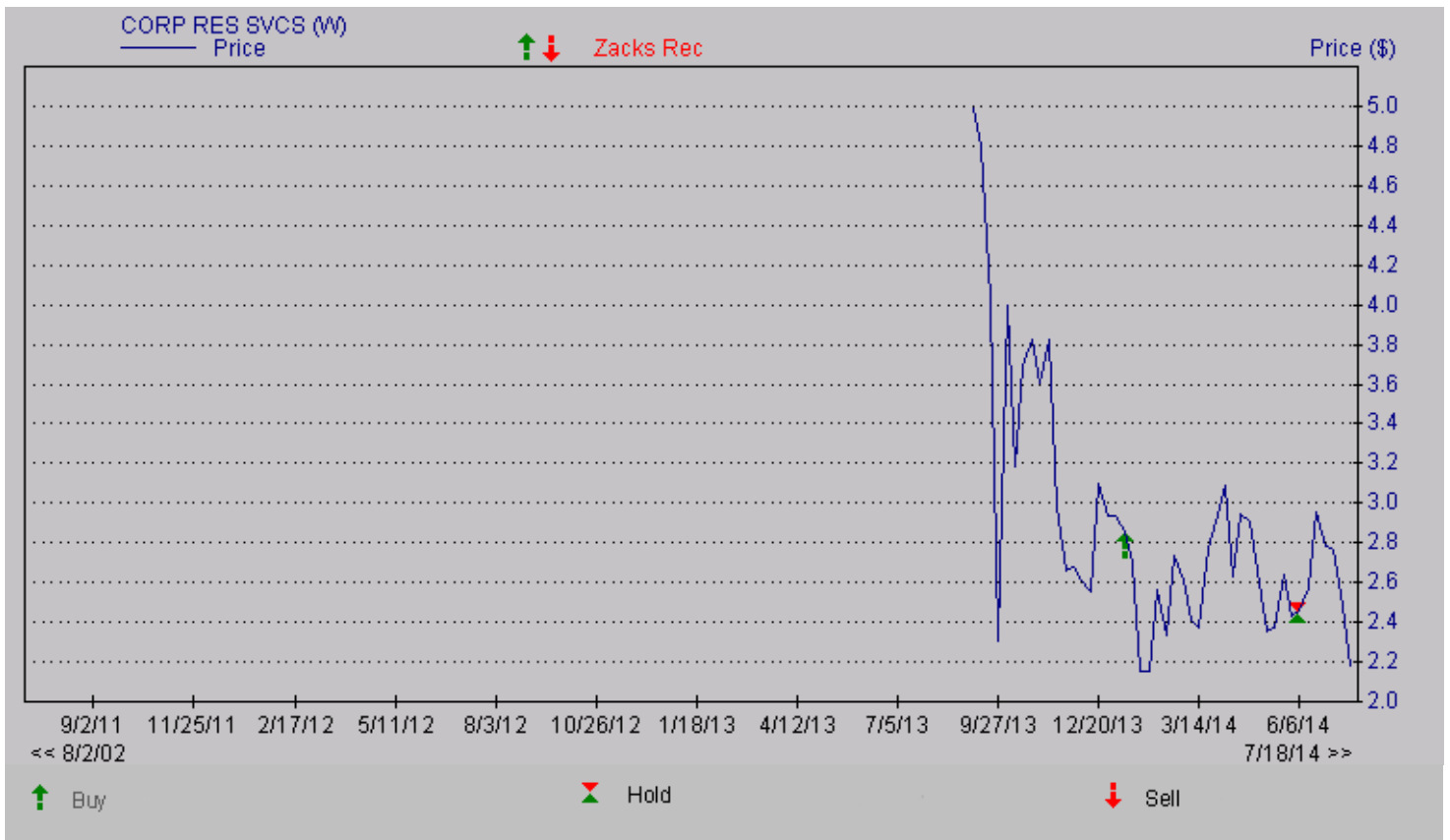
PROJECTED INCOME STATEMENT

Corporate Resource Services Income Statement & Projections (\$000 except per share data)

	Pro Forma										
	2012A	1Q13	2Q13	3Q13	4Q13A	2013A	1Q14E	2Q14E	3Q14E	4Q14E	2014E
Revenues	679,839	194,218	199,195	208,957	217,303	819,673	233,062	243,018	254,928	269,456	1,000,463
Direct cost related	596,166	171,633	175,197	182,256	188,147	717,233	202,600	211,255	221,609	234,238	869,702
Direct cost	3,643	936	972	784	3,372	6,064	1,025	1,069	1,020	1,078	4,192
Gross profit	80,030	21,649	23,026	25,917	25,784	96,376	29,436	30,693	32,299	34,140	126,568
S,G&A - related	47,864	15,012	12,176	12,058	9,849	49,095	13,401	13,974	14,658	15,494	57,527
S,G&A	25,717	4,821	6,660	7,660	10,151	29,292	8,157	8,506	8,922	9,431	35,016
D&A	2,012	416	363	466	549	1,794	449	392	466	550	1,857
Other	1,264				5,588	5,588					
Operating income	3,173	1,400	3,827	5,733	(353)	10,607	7,428	7,822	8,252	8,666	32,168
Interest expense	4,344	1,139	1,407	927	973	4,446	977	981	985	989	3,931
Int expense related	861	358	422	464	449	1,693			-	-	-
Acquisition exp	144	30	32	34	-	-	-	-	-	-	-
Other	669	(164)	10	24	1,114	1,080	10	10	10	10	40
Net inc/ (loss)	(1,219)	37	1,956	4,284	(2,889)	3,388	6,441	6,831	7,257	7,667	28,197
Noncontrolling interest		(82)	(71)	(113)	(346)	(612)	(614)	(617)	(619)	(622)	(2,473)
Taxes	518										
Net income (loss)	(1,737)	119	2,027	4,397	(3,235)	2,776	5,827	6,214	6,638	7,045	25,724
EPS											
Diluted	(\$0.01)	\$0.00	\$0.01	\$0.03	(\$0.02)	\$0.02	\$0.04	\$0.04	\$0.04	\$0.04	\$0.16
Avg shares out (FD)	148,377	156,150	158,422	162,896	172,600	162,517	163,517	164,517	165,517	166,517	165,017

Source: Company reports, Zacks Small Cap Research Estimates

HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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