Zacks Small-Cap Research

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# Corporate Resource Services (CRRS-NASDAQ)

## CRRS: *3Q14 Underscores Strong Revenue Growth*

| | |
|---|---|
| **Current Recommendation** | **Hold** |
| Prior Recommendation | Buy |
| Date of Last Change | 6/04/2014 |
| Current Price (08/28/14) | $1.25 |
| **Six- Month Target Price** | **$2.90** |

## OUTLOOK

Corporate Resource Services (CRS) reported results for its 3Q 2014 last night. On an organic basis, CRS generated strong revenue growth of roughly 9.3% year-over-year. Including the impact of recently acquired operations, revenue was up 24% year-over-year. The company also continues to move forward on its strategy to improve margins over time.

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## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$3.75** |
| **52-Week Low** | **$1.12** |
| **One-Year Return (%)** | **-68** |
| **Beta** | **1.68** |
| **Average Daily Volume (sh)** | **110,695** |
| **Shares Outstanding (mil)** | **164** |
| **Market Capitalization ($mil)** | **$205** |
| **Short Interest Ratio (days)** | **16.5** |
| **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** | **NM** |
| **P/E using 2014 Estimate** | **31.3** |
| **P/E using 2015 Estimate** | **5.7** |
| **Zacks Rank** | **2** |

| | |
|---|---|
| **Risk Level** | **Above Average** |
| **Type of Stock** | **Small-Growth** |
| **Industry** | **Business Svcs** |
| **Zacks Rank in Industry** | **11 of 35** |

## ZACKS ESTIMATES

**Revenue**
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec)* |
|---|---|---|---|---|---|
| 2012 | 145 A | 154 A | 180 A | 201 A | 680 A |
| 2013 | 194 A | 199 A | 209 A | 217 A | 820 A |
| 2014 | 218 A | 246 A | 260 A | 269 E | 994 E |
| 2015 | | | | | 1,200 E |

**Earnings per Share**
(EPS is operating earnings before non recurring items)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (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 | -$0.02 A | $0.00 A | $0.01 E | $0.04 E | $0.04 E |
| 2015 | | | | | $0.22 E |

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

*FY end has changed to Dec.in 2013 Disclosures pg 8

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## KEY POINTS

- Corporate Resource Services (CRS) reported results for its 3Q 2014 last night.
- Revenue of $260.3 million was up 24% year-over-year, with contributions from recently acquired operations adding $32.1 million. On an organic basis, revenue was up a strong 9.3%.
- Excluding non- recurring charges, adjusted EBITDA came in at $11.9 million versus $6.6 million recorded in 3Q 2013.
- Primarily reflecting higher borrowing costs, interest expense on the company's Wells Fargo facility increased $2.2 million compared to the third quarter of 2013.
- We believe risks include that CRS does not replace its existing asset-backed credit facility with another facility that provides better terms before the existing one expires in June 2015, 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.

## 3Q 2014 HIGHLIGHTS

With the issues of late reporting behind it, CRS is now Nasdaq compliant and back to a normal financial reporting schedule. The company announced results for its 3Q 2014 last night and hosted a conference call. CRS registered an impressive 24% revenue increase to $260.3 million, better than our $254.9 million forecast and compared to $209.0 million recorded in 3Q 2013. This growth partly reflects the impact of M&A transactions. Staffing companies acquired in late 2013 and earlier in 2014 contributed revenue of $32.1 million. On an organic basis, the company's growth was a strong 9.3%, which is impressive, we believe, particularly in light of the company's ongoing pruning of several unprofitable accounts, per a strategy launched in late 2013.

***Gross Margins***

The company intends to expand its gross margins by **diversifying its service offerings towards higher margin services, improving its pricing structure and managing unemployment claims to reduce state unemployment taxes**. These strategies contributed to some slight 20 bps gross margin improvement in the third quarter to 12.6% compared to 12.4% registered in last year's third quarter. Management expects gross margin improvement to continue over time. The company is also working to shift its service mix to higher margin services including temporary professional staffing service. While growth in this category has been strong, it remains low relative to the company's core, lower margin light industrial sector business and therefore does not yet have a meaningful impact on total margins. The company's continued roll-out of its higher margin software and screening offerings is also expected to contribute to margin expansion.

***Higher EBITDA***

Adjusted EBITDA came in at $11.9 million versus $6.6 million recorded in 3Q13. This equates to an impressive 80% increase on the higher revenue base. This metric also excludes $1.7 million in what management believes is non-recurring professional fees, largely reflecting the company's recent transition to new auditors and activities to regain Nasdaq compliance.

## BALANCE SHEET

Earlier this year, CRS amended its agreement with Wells Fargo, extending the term of its existing asset-backed credit facility 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 has indicated that it intends to replace this facility in order to reduce its borrowing costs and improve its financial flexibility. In the third quarter of 2014, primarily reflecting higher borrowing costs, interest expense on the Wells Fargo facility increased $2.2 million compared to the third quarter of 2013.

## RECENT NEWS

- On September 29, 2014, the company announced that it was fully compliant with the Nasdaq listing requirements.
- On September 29, 2014, CRS announced that it had added the President of PNC Bank-Pittsburgh, Sy Holzer, to its Board of Directors and that he would also serve as Chairman of its Audit Committee.
- CRS reported results for the third quarter of 2014 on November 13, 2014.

## RISKS

- CRS might not be able to replace the Wells Fargo line before it terminates in June 2015. The company also might not be able to replace it with one that provides better terms.
- 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 to yield results or might 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 CONTROL

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 | PF 1Q13 | 2Q13 | 3Q13 | 4Q13A | 2013A | 1Q14A | 2Q14A | 3Q14A | 4Q14E | 2014E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenues | 679,839 | 194,217 | 199,195 | 208,957 | 217,304 | 819,673 | 218,410 | 246,107 | 260,300 | 269,457 | 994,274 |
| Direct cost related | 596,166 | 172,298 | 175,197 | 182,256 | 187,482 | 717,233 | 194,182 | 217,234 | | 234,239 | 645,655 |
| Direct cost | 3,643 | 271 | 972 | 784 | 4,037 | 6,064 | 155 | (30) | | 1,078 | 1,203 |
| Gross profit | 80,030 | 21,648 | 23,026 | 25,917 | 25,785 | 96,376 | 24,073 | 28,903 | 32,700 | 34,140 | 119,816 |
| S,G&A - related | 47,864 | 14,286 | 12,176 | 12,058 | 10,575 | 49,095 | 12,948 | 13,490 | | 15,494 | 41,932 |
| S,G&A | 25,717 | 5,247 | 6,660 | 7,660 | 9,725 | 29,292 | 9,162 | 9,533 | | 9,431 | 28,126 |
| D&A | 2,012 | 391 | 363 | 466 | 574 | 1,794 | 1,144 | 880 | 896 | 575 | 3,495 |
| Other | 1,264 | 324 | | | 5,264 | 5,588 | 1,234 | 1,192 | | | |
| Operating income | 3,173 | 1,400 | 3,827 | 5,733 | (353) | 10,607 | (415) | 3,808 | | 8,641 | 12,034 |
| Interest expense | 4,344 | 1,166 | 1,407 | 927 | 946 | 4,446 | 980 | 1,316 | 4,332 | 992 | 7,620 |
| Int expense related | 861 | 359 | 422 | 464 | 448 | 1,693 | 691 | 941 | | - | 1,632 |
| Acquisition exp | 144 | - | 32 | 34 | - | - | | - | 2 | - | 2 |
| Other exp (inc) | 669 | 205 | 10 | 24 | 745 | 1,080 | 943 | 1,124 | 680 | 954 | 3,701 |
| Net inc / (loss) | (1,219) | (330) | 1,956 | 4,284 | (2,522) | 3,388 | (3,029) | 427 | | 6,695 | 4,093 |
| Noncontrolling interest | | - | (71) | (113) | (428) | (612) | (18) | - | | (18) | (36) |
| Taxes | 518 | 48 | | | | | | 97 | 301 | | |
| Net income (loss) | (1,737) | (378) | 2,027 | 4,397 | (2,950) | 2,776 | (3,047) | 524 | 2,432 | 6,676 | 6,585 |
| EPS | | | | | | | | | | | |
| Diluted | ($0.01) | ($0.00) | $0.01 | $0.03 | ($0.02) | $0.02 | ($0.02) | $0.00 | $0.01 E | $0.04 | $0.04 |
| Avg shares out (FD) | 148,377 | 159,433 | 158,422 | 162,896 | 169,317 | 162,517 | 158,015 | 163,783 | 164,783 E | 161,015 | 161,899 |

Source: Company reports, Zacks Small Cap Research Estimates

## HISTORICAL ZACKS RECOMMENDATIONS



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