ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.
Form 10-Q
August 09, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

Commission file number 001-35547

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-4392754**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

222 Merchandise Mart, Suite 2024

Chicago, IL 60654

(Address of principal executive offices)

(312) 506-1200

(Registrant s telephone number, including area code)

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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 definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of July 31, 2013, there were 178,063,213 shares of the registrant s $0.01 par value common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except per share amounts)	June 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 71,984	$ 103,956
Accounts receivable, net of allowance of $38,671 and $37,838 at June 30, 2013 and December 31, 2012, respectively	346,417	337,024
Deferred taxes, net	55,508	56,499
Prepaid expenses and other current assets	120,102	110,023
Total current assets	594,011	607,502
Long-term marketable securities	1,341	1,706
Fixed assets, net	170,950	155,494
Software development costs, net	90,521	95,579
Intangible assets, net	488,184	426,986
Goodwill	1,189,585	1,039,364
Deferred taxes, net	7,529	7,529
Other assets	133,824	50,304
Total assets	$ 2,675,945	$ 2,384,464
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 64,047	$ 45,874
Accrued expenses	89,225	93,100
Accrued compensation and benefits	47,503	44,124
Deferred revenue	327,363	290,653
Current maturities of long-term debt and capital lease obligations	10,736	79,305
Total current liabilities	538,874	553,056
Long-term debt	533,451	362,697
Deferred revenue	26,021	19,750
Deferred taxes, net	95,973	125,913
Other liabilities	114,046	38,707
Total liabilities	1,308,365	1,100,123
Commitments and contingencies		
Stockholders equity:		
Preferred stock: $0.01 par value, 1,000 shares authorized, no shares issued and outstanding at June 30, 2013 and December 31, 2012	0	0
Common stock: $0.01 par value, 349,000 shares authorized at June 30, 2013 and December 31, 2012; 262,629 and 177,957 shares issued and outstanding at June 30, 2013, respectively, 257,087 and 172,415 shares issued and outstanding at December 31, 2012, respectively	2,626	2,571

Treasury stock: at cost, 84,672 shares at June 30, 2013 and December 31, 2012	(278,036)	(278,036)
Additional paid-in capital	1,696,980	1,577,260
Accumulated deficit	(51,998)	(17,530)
Accumulated other comprehensive (loss) income	(1,992)	76
Total stockholders equity	1,367,580	1,284,341
Total liabilities and stockholders equity	$ 2,675,945	$ 2,384,464

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)	**Three Months Ended June 30, 2013**	**Three Months Ended June 30, 2012**	**Six Months Ended June 30, 2013**	**Six Months Ended June 30, 2012**
Revenue:				
System sales	$ 32,449	$ 43,716	$ 59,480	$ 80,956
Professional services	59,206	67,380	120,290	138,866
Maintenance	116,204	116,748	233,912	235,032
Transaction processing and other	136,968	142,112	278,211	279,814
Total revenue	344,827	369,956	691,893	734,668
Cost of revenue:				
System sales (excluding amortization of software development costs and acquisition-related assets shown below)	13,080	19,124	26,409	35,760
Amortization of software development costs and acquisition-related costs	19,991	15,939	39,530	30,888
Professional services	57,401	57,024	114,983	118,726
Maintenance	35,426	36,282	72,023	72,286
Transaction processing and other	82,647	84,097	168,238	163,841
Total cost of revenue	208,545	212,466	421,183	421,501
Gross profit	136,282	157,490	270,710	313,167
Selling, general and administrative expenses	104,402	92,291	208,634	189,608
Research and development	51,822	38,240	102,800	74,362
Amortization of intangible and acquisition-related assets	8,379	9,255	15,880	18,510
(Loss) income from operations	(28,321)	17,704	(56,604)	30,687
Interest expense	(9,499)	(4,358)	(14,136)	(8,212)
Interest income and other, net	218	150	8,349	542
(Loss) income before income taxes	(37,602)	13,496	(62,391)	23,017
Benefit (provision) for income taxes	14,726	(5,515)	27,923	(9,223)
Net (loss) income	($ 22,876)	$ 7,981	($ 34,468)	$ 13,794
(Loss) earnings per share basic and diluted	($ 0.13)	$ 0.04	($ 0.20)	$ 0.07

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

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ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	**2013**	**2012**	**2013**	**2012**
Net (loss) income	($ 22,876)	$ 7,981	($ 34,468)	$ 13,794
Other comprehensive (loss) income:				
Unrealized (loss) gain on marketable securities, net of tax	(20)	(1)	(16)	4
Derivatives:				
Unrealized loss on derivative financial instruments	(27)	(368)	(33)	(1,111)
Reclassification adjustment for loss included in net (loss) income	323	469	682	944
Tax effect	(116)	(40)	(252)	66
Unrealized gain (loss) on derivative financial instruments, net of tax	180	61	397	(101)
Change in foreign currency translation adjustments	(1,710)	(1,034)	(2,449)	(127)
Total other comprehensive (loss) income	(1,550)	(974)	(2,068)	(224)
Comprehensive (loss) income	($ 24,426)	$ 7,007	($ 36,536)	$ 13,570

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

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ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	**Six Months Ended June 30, 2013**	**2012**
Cash flows from operating activities:		
Net (loss) income	($ 34,468)	$ 13,794
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	84,965	72,885
Stock-based compensation expense	18,110	17,656
Excess tax benefits from stock-based compensation	(2,493)	(101)
Deferred taxes	(28,639)	7,052
Other losses, net	(24)	1,130
Changes in operating assets and liabilities, net of business combinations:		
Accounts receivable, net	(5,905)	(146)
Prepaid expenses and other assets	(21,706)	(8,576)
Accounts payable	21,103	15,997
Accrued expenses	(12,330)	(3,657)
Accrued compensation and benefits	929	(3,669)
Deferred revenue	36,605	20,481
Other liabilities	(5,351)	594
Net cash provided by operating activities	50,796	133,440
Cash flows from investing activities:		
Capital expenditures	(45,650)	(38,732)
Capitalized software	(19,516)	(26,936)
Cash paid for business acquisitions, net of cash acquired	(148,875)	0
Sales and maturities of other investments	12,844	41
Net cash used in investing activities	(201,197)	(65,627)
Cash flows from financing activities:		
Proceeds from issuance 1.25% senior cash convertible notes, net of issuance costs	337,237	0
Purchase of call option related to 1.25% senior cash convertible notes	(82,800)	0
Proceeds from issuance of warrants	51,233	0
Proceeds from issuance of common stock	9,264	3,862
Excess tax benefits from stock-based compensation	2,493	101
Taxes paid related to net share settlement of equity awards	(6,660)	(3,621)
Payments of capital lease obligations	(300)	(431)
Payments of acquisition financing obligations	(29,671)	0
Credit facility payments	(571,467)	(204,045)
Credit facility borrowings, net of issuance costs	410,983	324,185
Repurchase of common stock	0	(225,961)
Net cash provided by (used in) financing activities	120,312	(105,910)
Effect of exchange rate changes on cash and cash equivalents	(1,883)	717
Net (decrease) increase in cash and cash equivalents	(31,972)	(37,380)
Cash and cash equivalents, beginning of period	103,956	157,753
Cash and cash equivalents, end of period	$ 71,984	$ 120,373

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Allscripts Healthcare Solutions, Inc. and our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Certain prior period revenue amounts in system sales have been reclassified to maintenance revenue to conform to the current period presentation. The amount reclassified for each period is as follows:

(In thousands)	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
	2013	**2012**	**2013**	**2012**
Revenue reclassifications from system sales to maintenance	$ 0	$ 2,849	$ 0	$ 6,317

Unaudited Interim Financial Information

The unaudited interim consolidated financial statements as of and for the three and six months ended June 30, 2013 have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. These consolidated financial statements are unaudited and, in the opinion of management, include all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly the consolidated financial statements for the periods presented in accordance with generally accepted accounting principles in the United States of America (GAAP). The results of operations for the three and six months ended June 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the SEC s rules and regulations for interim reporting. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K/A for the year ended December 31, 2012.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Significant Accounting Policies

There have been no changes to our significant accounting policies from those disclosed in our Annual Report on Form 10-K/A for the year ended December 31, 2012.

Business Combinations

Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While we use our best estimates and assumptions as a part of the purchase price allocation process to accurately value assets acquired, including intangible assets, and liabilities assumed at the acquisition date, our estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our consolidated statements of operations.

Goodwill and Intangible Assets

Goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized in accordance with accounting guidance, but accounting guidance requires that we perform an impairment test at least annually. The goodwill impairment analysis is comprised of two steps. In step one the estimated fair value of a reporting unit is compared to its carrying value. Step two is required only if there is a deficiency (the estimated fair value is less than the carrying value). In step two the actual amount of the goodwill impairment is calculated by comparing the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. The implied fair value is determined in the same manner as the amount of goodwill recognized in a business combination. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, then an impairment loss equal to the difference would be recorded. The recoverability of indefinite lived intangible assets is assessed by comparison of the carrying value of the asset to its estimated fair value. If we determine that the carrying value of the asset exceeds its estimated fair value, an impairment loss would be recorded equal to the excess. We perform our annual test for impairment of goodwill and indefinite lived intangible assets as of the first day of our fiscal fourth quarter. We do not test our goodwill and indefinite lived intangible assets for impairment at any other time unless specific circumstances indicate there is a possibility that impairment has occurred. Accordingly, we did not perform any tests for impairment during the three and six months ended June 30, 2013.

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Accounting guidance also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives and reviewed for impairment. We estimate the useful lives of our intangible assets and ratably amortize the value over the remaining estimated economic lives of those assets, including the period being reported on. If the actual useful life is shorter than our estimated useful life, we will amortize the remaining book value over the remaining useful life or the asset may be deemed to be impaired and, accordingly, a write-down of the value of the asset may be required.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued updated authoritative guidance regarding the presentation requirements for reclassifications out of accumulated other comprehensive income. This guidance requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. This guidance is effective prospectively for reporting periods beginning after December 15, 2012. This guidance will not have a material impact on the consolidated financial statements.

In March 2013, the FASB issued updated authoritative guidance to resolve the diversity in practice about whether FASB Account Standards Codification (ASC) Subtopic 810-10, Consolidation Overall, or ASC Subtopic 830-30, Foreign Currency Matters Translation of Financial Statements, applies to the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity. In addition, this guidance resolves the diversity in practice for the treatment of business combinations achieved in stages (sometimes also referred to as step acquisitions) involving a foreign entity. This guidance is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. This guidance is not expected to have a material impact on the consolidated financial statements.

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2. Business Combinations

To better deliver comprehensive care coordination and population health management across hospitals, physician practices, and home care systems, in the first fiscal quarter of 2013 we acquired dbMotion, Ltd. (dbMotion), a leading supplier of community health solutions, and we acquired the assets of Jardogs LLC (Jardogs), a top-rated patient engagement solution provider, both privately held. These acquisitions advance our strategy to offer full integration of heterogeneous systems across the care continuum, enabling solutions for a Connected Community of Health . dbMotion provides a strategic platform for care coordination and population health management that integrates discrete patient data from diverse care settings, regardless of IT supplier, into a single patient record. The Jardogs FollowMyHealth patient engagement platform enables patients to actively participate in their care, critical for at-risk populations, and empowers consumers with the solution they need to monitor and optimize health status.

Acquisition of dbMotion, Ltd.

On March 4, 2013, we acquired all of the issued and outstanding share capital of dbMotion, a privately-held Israeli Company, for aggregate consideration with a fair value of approximately $225 million, subject to adjustment for certain provisional items as noted below. Immediately prior to the closing, we owned approximately 4.25% of the issued and outstanding share capital of dbMotion on a fully diluted basis. In addition, prior to the acquisition we had an ongoing strategic relationship with dbMotion in connection with the development and sale of software solutions to hospitals, physicians and other participants in the healthcare industry.

Under the acquisition method of accounting, the fair value of consideration transferred was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date with the remaining unallocated amount recorded as goodwill.

The results of dbMotion are included in the accompanying consolidated statements of operations from the date of the acquisition, March 4, 2013.

The total fair value of consideration transferred for the acquisition is comprised of the following:

(Dollar amounts in thousands, except per share amounts)	
Cash	$ 139,061
Allscripts common stock, 3,823,453 shares, par value $0.01 per share, fair value at closing $12.57 per share	48,061
Deferred cash consideration payable on the 18-month anniversary of the closing	23,023
Subordinated promissory note maturing 18 months following the closing	6,648
Fair value of Allscripts previous interest in dbMotion	8,367
Total fair value of consideration transferred	$ 225,160

On March 5, 2013, we borrowed $130 million to fund the cash component of the consideration under our senior secured revolving credit facility. On June 28, 2013, the liability for the deferred cash consideration payable was funded by placing the funds with an escrow agent, and the subordinated promissory note was paid off. Both the deferred cash consideration and subordinated promissory note had accrued interest at a 10% annual rate. These transactions were funded using proceeds from the initial draw down on our new revolving credit facility (Note 7).

The carrying value of our 4.25% interest in dbMotion prior to the acquisition was $5 million, accounted for using the cost method. In connection with the acquisition, this investment was remeasured to a fair value of approximately $8.4 million resulting in a gain of approximately $3.4 million which is included in interest income and other, net, in the accompanying consolidated statement of operations for the six months ended June 30, 2013. The remeasured fair value of our prior interest in dbMotion was estimated based on the fair value of consideration transferred to acquire the remaining 95.75% of the company, less an estimated control premium of 15%. The inputs into this fair value estimate reflect our market assumptions based on premiums observed in similar transactions within our industry.

The preliminary allocation of the fair value of the consideration transferred was based upon a preliminary valuation. Our estimates and assumptions are subject to change as we obtain additional information for our estimates during the measurement period (up to one year from the acquisition date). The primary area of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relates to the fair value of the total consideration transferred and therefore may result in an additional increase in the residual value allocated to goodwill of up to $1 million before the close of the measurement period. During the six months ended June 30, 2013, measurement period adjustments,

including approximately $1 million to increase deferred cash consideration, $1.2 million to reduce the fair value of prepaid expenses and other current assets, $1.3 million to reduce the fair value of other long-term assets, $0.5 million to reduce the fair value of other accrued liabilities, and other minor adjustments to acquired cash and net deferred tax liabilities, combined to result in an increase of approximately $3.2 million in the residual allocation to goodwill. The preliminary allocation of the fair value of the consideration transferred, including measurement period adjustments through June 30, 2013, is as follows:

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(In thousands)	
Acquired cash and cash equivalents, and restricted cash	$ 14,188
Accounts receivable, net	3,226
Prepaid expenses and other current assets	574
Fixed assets and other long-term assets	1,449
Goodwill	136,631
Intangible assets	85,450
Accounts payable and accrued liabilities	(10,560)
Deferred taxes, net	(36)
Deferred revenue	(5,100)
Other liabilities	(662)
Net assets acquired	$ 225,160

Goodwill was determined based on the residual difference between the fair value of the consideration transferred and the value assigned to tangible and intangible assets and liabilities, and is not deductible for tax purposes. Among the factors that contributed to a purchase price resulting in the recognition of goodwill were the expected synergies that we believe will result from the integration of dbMotion s product offerings with those of Allscripts.

Acquisition and integration-related costs related to the dbMotion acquisition are included in selling, general and administrative expenses and totaled approximately $5.6 million and $7.0 million for the three and six months ended June 30, 2013, respectively. Included in these costs are seller transaction costs of $0.5 million during the six months ended June 30, 2013, employee compensation of approximately $1.9 million and $2.4 million for the three and six months ended June 30, 2013, respectively, and $2.8 million for the three and six months ended June 30, 2013 related to product consolidation activities. Additional employee compensation of approximately $5.6 million related to the dbMotion acquisition is expected to be incurred during the next nine to fifteen months following the second quarter of fiscal 2013.

The acquired intangible assets are being amortized on a straight-line basis over their useful lives and consist of the following amounts for each class of acquired intangible asset representing a provisional allocation of the fair value of consideration transferred subject to future adjustment pending the completion of our acquisition accounting as noted above:

(Dollar amounts in thousands)

Description	Useful Life in Years	Fair Value
Core technology	10	$ 80,100
Maintenance agreements	12	2,500
Services backlog	2	2,000
Non-compete	3	500
Trade name	2	350
		$ 85,450

The revenue and net loss of dbMotion since March 4, 2013 that are included in our consolidated statement of operations for the three and six months ended June 30, 2013, and the supplemental pro forma revenue and net loss of the combined entity, presented as if the acquisition of dbMotion had occurred on January 1, 2012, are as follows:

(In thousands)	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Actual from dbMotion since acquisition date of March 4, 2013:				
Revenue	$ 554	$ 0	$ 728	$ 0
Net loss	($ 8,693)	$ 0	($ 11,540)	$ 0
Supplemental pro forma data for combined entity:				

Revenue	$ 346,162	$ 369,971	$ 694,422	$ 735,042
Net loss	($ 19,619)	$ 3,681	($ 42,633)	($ 74)
Net loss per share, basic and diluted	($ 0.11)	$ 0.02	($ 0.24)	($ 0.00)

The supplemental pro forma data has been calculated after applying our accounting policies and adjusting the results of dbMotion to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had been applied on January 1, 2012, together with the consequential tax effects. Supplemental pro forma earnings for the three and six months ended June 30, 2013 were adjusted to exclude acquisition-related costs incurred during the period as well as the nonrecurring gain related to the fair value adjustment of our prior cost method investment in dbMotion. Supplemental pro forma earnings for the three and six months ended June 30, 2012 were adjusted to include these items. The effects of transactions between Allscripts and dbMotion during the periods presented have been eliminated.

Amortization of software development costs and acquisition-related assets in our consolidated statement of operations for the three and six months ended June 30, 2013 includes approximately $0.6 million and $1.8 million, respectively, related to the acquisition of dbMotion, which is attributable to cost of revenue as follows: approximately $0.3 million and $0.7 million, respectively, related to system sales, approximately ($0.5) million and $0.1 million, respectively, related to professional services, and approximately $0.8 million and $1.0 million, respectively, related to maintenance.

Acquisition of Jardogs LLC

Also on March 4, 2013, we acquired substantially all of the assets of Jardogs LLC (Jardogs) for $24 million in cash. The allocation of the fair value of the consideration transferred is as follows: approximately $4 million of intangible assets related to technology, including Jardogs portal software, $2 million of intangible assets related to customer relationships, net deferred tax assets of approximately $0.5 million, and goodwill of approximately $17 million. Goodwill was determined based on the residual difference between the fair value of the consideration transferred and the value assigned to tangible and intangible assets and liabilities, and is deductible for tax purposes. Among the factors that contributed to a purchase price resulting in the recognition of goodwill were the expected synergies that we believe will result from the integration of Jardogs product offerings with those of Allscripts. The acquired intangible assets, excluding goodwill, have estimated lives of 10 years and are being amortized on a straight-line basis.

The pro forma impact of the Jardogs acquisition on current and prior periods, as well as the net revenues and operating losses generated by Jardogs subsequent to its acquisition for the three and six months ended June 30, 2013, are not material.

Acquisition and integration-related costs related to the Jardogs acquisition are included in selling, general and administrative expenses and totaled approximately $0.1 million and $0.7 million for the three and six months ended June 30, 2013.

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3. Fair Value Measurements

The fair values of assets and liabilities required to be measured at fair value are categorized based upon the level of judgment associated with the inputs used to measure their value. Hierarchical levels are as follows:

Level 1: Inputs are unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date. Our Level 1 investments include money market funds valued daily by the fund companies, and the valuation is based on the publicly reported net asset value of each fund.

Level 2: Inputs, other than quoted prices included in Level 1, are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar instruments in active markets, and inputs other than quoted prices that are observable for the asset or liability. Our Level 2 non-derivative investments include marketable securities and consist of mortgage and asset-backed bonds. Marketable securities are recorded at fair value determined using a market approach, based on prices and other relevant information generated by market transactions involving identical or comparable assets which are considered to be Level 2 inputs. Our Level 2 derivative financial instrument represents an interest rate swap contract which is valued based upon observable values for underlying interest rates and market determined risk premiums.

Level 3: Inputs are unobservable for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Our Level 3 financial instruments include derivative financial instruments comprising the 1.25% Call Option asset and the embedded conversion option liability. See Note 7, Debt, and Note 9, Derivative Financial Instruments, for further information, including defined terms, regarding our derivative financial instruments. These derivatives are not actively traded and are valued based on an option pricing model that uses observable and unobservable market data for inputs. Significant market data inputs used to determine fair value as of June 30, 2013 included our common stock price, time to maturity of the derivative instruments, the risk-free interest rate, and the implied volatility of our common stock. The 1.25% Call Option asset and the embedded cash conversion option liability were designed with the intent that changes in their fair values would offset, with minimal impact to the consolidated statements of operations. Therefore, the sensitivity of changes in the unobservable inputs to the option pricing model for such instruments is mitigated.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of the respective balance sheet dates:

	Balance Sheet	**June 30, 2013**				**December 31, 2012**			
(In thousands)	**Classifications**	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market funds	Cash equivalents	$ 3,802	$ 0	$ 0	$ 3,802	$ 14,653	$ 0	$ 0	$ 14,653
Marketable securities	Long-term marketable securities	0	1,341	0	1,341	0	1,706	0	1,706
1.25%Call Option	Other assets	0	0	81,074	81,074	0	0	0	0
Cash conversion option	Other liabilities	0	0	(81,074)	(81,074)	0	0	0	0
Interest rate swap	Other liabilities	0	(885)	0	(885)	0	(1,534)	0	(1,534)
Total		$ 3,802	$ 456	$ 0	$ 4,258	$ 14,653	$ 172	$ 0	$ 14,825

At December 31, 2012 we held investments in certain non-marketable equity securities in which we did not have a controlling interest or significant influence. These investments were recorded at cost with a carrying value of $13 million at December 31, 2012 and were included in other assets in the accompanying consolidated balance sheets. During the first fiscal quarter of 2013, one of these investments, Humedica, was sold for cash proceeds of approximately $12.5 million, plus an additional $2 million held in escrow, resulting in a gain of approximately $4.7 million which is included in interest income and other, net, in the accompanying consolidated statement of operations for the six months ended June 30, 2013. The $2 million escrow receivable has been included in our consolidated balance sheet as $0.7 million included in prepaid expenses and other current assets and $1.3 million in other assets and has been recorded at its estimated fair value based upon our estimate of its present value and collectability. The inputs into this fair value estimate reflect our market assumptions and are not observable. Consequently, the inputs are considered to be Level 3 as specified in the fair value hierarchy. The other significant investment in non-marketable equity securities consisted of our 4.25% equity interest in dbMotion. On March 4, 2013, we acquired the entire remaining interest in dbMotion, which is now consolidated in our financial statements. Refer to Note 2
style="margin-bottom:0pt;margin-top:0pt;margin-left:0pt;;text-indent:0pt;;color:#000000;font-size:9pt;font-family:Times New Roman;font-weight:normal;font-style:normal;text-transform:none;font-variant: normal;">

6,439

22,218

13,562

Depreciation and amortization

712

760

1,510

1,520

Total Operating Expenses

11,742

7,199

23,728

15,082

Income (Loss) From Operations

140

725

(265

)

168

Other (Expenses) Income:

Interest expense

(1,951

)

(580

)

(3,906

)

(1,082

)

Amortization of debt discount and deferred financing costs

(115

)

(839

)

(237

)

(1,398

)

Loss on extinguishment of debt, net

—

—

—

(1,368

)

Change in fair value of warrant liability

341

287

879

195

Gain from sale of business

238

—

238

—

Re-measurement loss on intercompany note

(721

)

—

(146

)

—

Other, net

(9

)

(23

)

241

(19

)

Total Other Expenses, net

(2,217

)

(1,155

)

(2,931

)

(3,672

)

Loss Before Provision for Income Tax

(2,077

)

(430

)

(3,196

)

(3,504

)

Benefit from (Provision for) income taxes

233

(2

)

81

(7

)

Net Loss

(1,844

)

(432

)

(3,115

)

(3,511

)

Dividends - Series A preferred stock - related party

50

50

100

100

Deemed Dividends - Series D preferred stock

—

1,129

—

2,009

Net Loss Attributable to Common Stock Holders

$

(1,894

)

$

(1,611

)

$

(3,215

)

$

(5,620

)

Basic and Diluted Net Loss per Share:

Net Loss

$

(0.45

)

$

(0.16

)

$

(0.77

)

$

(1.41

)

Net Loss Attributable to Common Stock Holders

$

(0.46

)

$

(0.59

)

$

(0.79

)

$

(2.26

)

Weighted Average Shares Outstanding – Basic and Diluted

4,142,309

2,715,189

4,063,316

2,487,523

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

STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(All amounts in thousands)

(UNAUDITED)

	Q2 2018	Q2 2017	Q2 2018 YTD	Q2 2017 YTD
Net Loss	$(1,844)	$(432)	$(3,115)	$(3,511)
Other Comprehensive loss				
Foreign exchange translation adjustment	1,254	(281)	338	(303)
Comprehensive Loss Attributable to the Company	$(590)	$(713)	$(2,777)	$(3,814)

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

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STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(All amounts in thousands)

(UNAUDITED)

	Q2 2018 YTD	Q2 2017 YTD
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(3,115)	$(3,511)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,510	1,520
Amortization of debt discount and deferred financing costs	237	1,398
Loss on extinguishment of debt, net	—	1,368
Gain in fair value of warrants	(879)	(195)
Stock based compensation	663	618
Re-measurement loss on intercompany note	146	—
Gain from sale of business	(238)	—
Other	—	(87)
Changes in operating assets and liabilities:		
Accounts receivable	12,919	2,281
Prepaid expenses and other current assets	(57)	(269)
Other assets	(58)	295
Accounts payable and accrued expenses	1,960	(1,201)
Interest payable - related party	(160)	—
Other current liabilities	(88)	138
Other long-term liabilities	(11)	53
Other	167	(304)
NET CASH PROVIDED BY OPERATING ACTIVITIES	12,996	2,104
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	(1,910)	—
Disposal of business, net of cash	1,968	—
Purchase of property and equipment	(140)	(126)
Collection of UK factoring facility deferred purchase price	3,550	—
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	3,468	(126)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of term loan	(254)	—
Repayment of promissory notes	—	(5,486)
Proceeds from term loan - related party	—	9,050
Proceeds from term loan	2,047	—
Proceeds from convertible notes	—	400
Repayment of bonds	—	(50)

Repayments on accounts receivable financing, net	(18,813)	(2,709)
Dividends paid to related parties	(100)	—
Proceeds from At-The-Market Facility	629	208
Repayment of Series D Preferred Stock	—	(1,500)
Payments made for earn-outs	(165)	(1,075)
Third party financing costs	(20)	(938)
NET CASH USED IN FINANCING ACTIVITIES	(16,676)	(2,100)
NET DECREASE IN CASH	(212)	(122)
Effect of exchange rates on cash	(2)	(2)
Cash - Beginning of period	3,100	650
Cash - End of period	$2,886	$526

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

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STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

NOTE 1 – ORGANIZATION AND DESCRIPTION OF BUSINESS

Staffing 360 Solutions, Inc. ("we," "us," "our," "Staffing 360," or the "Company") was incorporated in the State of Nevada on December 22, 2009, as Golden Fork Corporation, which changed its name to Staffing 360 Solutions, Inc., ticker symbol "STAF", on March 16, 2012. On June 15, 2017, the Company changed its state of domicile to Delaware.

The Company effected a one-for-ten reverse stock split on September 17, 2015 and a one-for-five reverse stock split on January 3, 2018. All share and per share information in these consolidated financial statements has been retroactively adjusted to reflect these reverse stock splits.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

These condensed consolidated financial statements and related notes are presented in accordance with generally accepted accounting principles in the United States ("GAAP"), expressed in U.S. dollars.

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements reflect all adjustments including normal recurring adjustments, which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows for the periods presented in accordance with the GAAP.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the fiscal year ended December 30, 2017, the transition period ended December 31, 2016 and fiscal year ended May 31, 2016, which are included in the Company's December 30, 2017 Form 10-K, filed with the United States Securities and Exchange Commission on March 29, 2018. The Company assumes that the users of the interim financial information herein have read, or have access to, the audited consolidated financial statements for the preceding period, and that the adequacy of additional disclosure needed for a fair presentation may be determined in that context. The results of operations for the period ended June 30, 2018 are

not necessarily indicative of results for the entire year ending December 29, 2018. This report is for the periods April 1, 2018 to June 30, 2018 (“Q2 2018”), April 2, 2017 to July 1, 2017 (“Q2 2017”), December 31, 2017 to June 30, 2018 (“Q2 2018 YTD”) and January 1, 2017 to July 1, 2017 (“Q2 2017 YTD”).

Clement May Acquisition

On June 28, 2018, the Company and Longbridge Recruitment 360 Limited (“Longbridge”), a wholly-owned subsidiary of the Company, entered into share purchase agreements (“Share Purchase Agreements”) to acquire all of the share capital of Clement May Limited (“CML”). Consideration for the acquisition of all the shares was (i) an aggregate cash payment of £1,550 ($2,047), (ii) 15,000 shares of the Company’s common stock, (iii) the assignment of certain outstanding debt owed to the CML Majority Holder to the Principal as set forth in that Share Purchase Agreement, (iv) an earn-out payment of up to £500, the amount to be calculated pursuant to that Share Purchase Agreement and to be paid on or around December 28, 2018, and (v) deferred consideration of £350, to be paid on or around June 28, 2019, depending on the satisfaction of certain conditions set forth in that Share Purchase Agreement. To finance the above transaction, the Company entered into a term loan with HSBC Bank plc. Refer to Note 5 for further details.

PeopleServe Disposition

On June 6, 2018, the Company divested the stock of PeopleServe Inc., and PeopleServe PRS, Inc. for a total consideration of $1,502, net of $567 that was remitted back to the buyer on July 31, 2018 in connection with a net working capital true up. The Company recorded a gain of $238 from sale of the business.

Revenue Recognition

On January 1, 2018, the Company adopted the new accounting standard ASC 606, Revenue from Contracts with Customers for all open contracts and related amendments as of January 1, 2018 using the modified retrospective method. The adoption had no impact to the

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STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

reported results. Results for reporting periods beginning after January 1, 2018 will be presented under ASC 606, while the comparative information will not be restated and will continue to be reported under the accounting standards in effect for those periods.

The Company accounts for revenues when both parties to the contract have approved the contract, the rights and obligations of the parties are identified, payment terms are identified, and collectability of consideration is probable. Payment terms vary by client and the services offered.

The Company has primarily two main forms of revenue – temporary contractor revenue and permanent placement revenue. Temporary contractor revenue is accounted for as a single performance obligation satisfied over time because the customer simultaneously receives and consumes the benefits of the Company’s performance on an hourly basis. The contracts stipulate weekly billing and the Company has elected the “as invoiced” practical expedient to recognize revenue based on the hours incurred at the contractual rate as we have the right to payment in an amount that corresponds directly with the value of performance completed to date. Permanent placement revenue is recognized on the date the candidate’s full-time employment with the customer has commenced. The customer is invoiced on the start date, and the contract stipulates payment due under varying terms, typically 30 days. The contract with the customer stipulates a guarantee period whereby the customer may be refunded if the employee is terminated within a short period time, however this has historically been infrequent, and immaterial upon occurrence. As such, the Company’s performance obligations are satisfied upon commencement of the employment, at which point control has transferred to the customer. Revenue in Q2 2018 was comprised of $56,838 of temporary contractor revenue and $2,889 of permanent placement revenue, compared with $41,323 and $794 for Q2 2017, respectively. Revenue in Q2 2018 YTD was comprised of $109,835 of temporary contractor revenue and $5,683 of permanent placement revenue, compared with $81,250 and $1,579 for Q2 2017 YTD, respectively. Refer to Note 8 for further details on breakdown by segments.

Reclassifications

We may make certain reclassifications to prior period amounts to conform with the current year’s presentation. These reclassifications did not have a material effect on our condensed consolidated statement of financial position, results of operations or cash flows.

Income Taxes

The Company's provision for income taxes is based upon an estimated annual tax rate for the year applied to federal, state and foreign income. On a quarterly basis, the annual effective tax rate is adjusted, as appropriate, based upon changed facts and circumstances, if any, as compared to those forecasted at the beginning of the fiscal year and each interim period thereafter. The Company’s effective tax rate may change from period to period based on recurring and non-recurring factors including the geographical mix of earnings, enacted tax legislation, state and local income taxes, and tax audit settlements. The effective income tax rate was 2.52%, 12.8%, 11.1% and 8% for the period ending Q2 2018, Q2 2017, Q2 2018 YTD and Q2 2017 YTD, respectively.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the "Tax Act") was signed into law making significant changes to the Internal Revenue Code. The changes include, but are not limited to, a U.S. corporate tax rate decrease from 35% to 21%, the transition of U.S. international taxation from a worldwide tax system to a territorial system, allowing for immediate expensing of certain qualified property, modifications to many business deductions and credits, and providing various tax incentives. Shortly after the Tax Act was enacted, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. SAB 118 provides that in these cases a registrant should continue to apply Financial Accounting Standards Board ("FASB") Accounting Standards Update No. 2009-06, Income Taxes ("Topic 740") based on the provisions of the tax laws that were in effect immediately prior to the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for registrants to complete the accounting under Topic 740.

The Company remeasured domestic deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally the 21% rate imposed by the Tax Act. The Company recorded an expense of $3.7 million to reduce the net deferred tax assets, along with a corresponding benefit for the reduction of the valuation allowance recorded against these balances in our financial statements for the year ended December 30, 2017.

At June 30, 2018, in accordance with SAB 118, the Company has not completed its accounting for the tax effects of the one-time transition tax imposed by the Tax Act. In order to determine the amount of the liability with respect to the one-time transition tax, the Company must determine, in addition to other factors, the amount of post-1986 Earnings & Profits of the relevant subsidiaries, as well as the amount of non-U.S. income taxes paid on such earnings. In order to quantify the liability, we are awaiting further interpretative guidance, continuing to assess available tax methods and elections, and continuing to gather additional information to more precisely compute the amount of the transition tax. Therefore, we have not recorded an estimate of the transition tax in our financial statements.

STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

In addition, the Company is continuing to evaluate whether Global Intangible Low Tax Income taxes ("GILTI") are recorded as a current period expense when incurred or whether such amounts should be factored into the Company's measurement of its deferred taxes. As a result, the Company has not included an estimate of the tax impacts related to GILTI in the second quarter of 2018. The Company has not elected a method and will only do so after completing their analysis of the GILTI provisions.

Foreign Currency

Staffing 360 Solutions, Inc. has an intercompany note due from Longbridge Recruitment 360 (U.K.) Limited ("Longbridge"), denominated in U.S. dollars. Longbridge's functional currency is Pound Sterling. The note matures in September 15, 2022, bears interest at a rate of interest equal to the mid-term monthly Applicable Federal Rate (AFR), as published each month by the U.S. Internal Revenue Service pursuant to Section 1274(d) of the Internal Revenue Code, compounded semiannually. Interest is payable in cash quarterly on the first business day of each calendar quarter. Longbridge may prepay all or any portion of the principal amount of this Note at any time, in whole or in part, without premium or penalty. As the note is denominated in U.S. dollars and due to weakening of the Pound Sterling, the Company recorded a non cash foreign currency remeasurement loss of $721 and $146 in Q2 2018 and Q2 2018 YTD, respectively.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842). This guidance will be effective for public entities for fiscal years beginning after December 15, 2018 including the interim periods within those fiscal years. Early application is permitted. Under the new provisions, all lessees will report a right-of-use asset and a liability for the obligation to make payments for all leases with the exception of those leases with a term of 12 months or less. All other leases will fall into one of two categories: (i) Financing leases, similar to capital leases, which will require the recognition of an asset and liability, measured at the present value of the lease payments and (ii) Operating leases which will require the recognition of an asset and liability measured at the present value of the lease payments. Lessor accounting remains substantially unchanged with the exception that no leases entered into after the effective date will be classified as leveraged leases. For sale leaseback transactions, the sale will only be recognized if the criteria in the new revenue recognition standard are met. The Company is currently evaluating the impact of adopting this guidance.

NOTE 3 – LOSS PER COMMON SHARE

The Company utilizes the guidance per ASC 260, "Earnings per Share". Basic earnings per share are calculated by dividing income available to stockholders by the weighted average number of common stock shares outstanding during each period. Our Series A preferred stock holders (related parties) receive certain dividends or dividend equivalents that are considered participating securities and our loss per share is computed using the two-class method. For Q2 2018 YTD and Q2 2017 YTD, pursuant to the two-class method, as a result of the net loss, losses were not allocated to the participating securities.

Diluted earnings per share are computed using the weighted average number of common stock shares and dilutive common share equivalents outstanding during the period. Dilutive common stock equivalents consist of common shares issuable upon the conversion of preferred stock, convertible notes and the exercise of stock options and warrants (calculated using the modified treasury stock method). Such securities, shown below, presented on a common share equivalent basis and outstanding as of June 30, 2018 and July 1, 2017 have been excluded from the per share computations, since their inclusion would be anti-dilutive:

	June 30, 2018	July 1, 2017
Convertible promissory notes	—	253,885
Convertible preferred shares	43,239	43,239
Warrants	925,935	912,234
Restricted shares - unvested	565,932	271,852
Long term incentive plan (LTIP)	178,728	178,728
Options	125,400	125,460
Total	1,839,234	1,785,398

STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

NOTE 4 – ACCOUNTS RECEIVABLE BASED FINANCING FACILITIES

HSBC Invoice Finance (UK) Ltd – New Facility

On February 8, 2018, CBS Butler, Longbridge and The JM Group, entered into a new arrangement with HSBC Invoice Finance (UK) Ltd ("HSBC") which provides for HSBC to purchase the subsidiaries' accounts receivable up to an aggregate amount of £11,500 across all three subsidiaries. The terms of the arrangement provide for HSBC to fund 90% of the purchased accounts receivable upfront and, a secured borrowing line of 70% of unbilled receivables capped at £1,000 (within the overall aggregate total facility of £11,500). The arrangement has an initial term of 12 months, with an automatic rolling three-month extension and carries a service charge of 1.80%.

On June 28, 2018, the Company's new subsidiary Clement May Limited ("CML") entered into a new agreement with a minimum term of twelve months for purchase of debt ("APD") with HSBC, joining CBS Butler, Longbridge and The JM Group (collectively, with CML, the "Borrowers") as "Connected Clients" as defined in the APD. The new Connected Client APDs carry an aggregate Facility Limit of £20,000 across all Borrowers. The obligations of the Borrowers are secured by a fixed charge and a floating charge on the Borrowers' respective accounts receivable and are subject to cross-company guarantees among the Borrowers. In addition, the secured borrowing line against unbilled receivables was increased to £1,500 for a period of 90 days.

Under ASU 2016-16, "Statement of Cash Flows (Topic 230, Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force), the upfront portion of the sale of accounts receivable is classified within operating activities, while the deferred purchase price portion (or beneficial interest), once collected, is classified within investing activities.

ABN AMRO Commercial Finance

In conjunction with the HSBC Invoice Finance (UK) Ltd – New Facility, on February 8, 2018, Longbridge and The JM Group terminated this facility and the remaining balance was paid in full.

CBS Butler

In conjunction with the HSBC Invoice Finance (UK) Ltd – New Facility, on February 8, 2018, CBS Butler terminated this facility and the remaining balance was paid in full.

NOTE 5 – DEBT

	June 30, 2018	December 30, 2017
Jackson Investment Group - related party	$40,000	$ 40,000
HSBC Term Loan	2,047	—
ABN AMRO	—	254
Total Debt, Gross	42,047	40,254
Less: Debt Discount and Deferred Financing Costs	(1,022)	(1,260)
Total Debt, Net	41,025	38,994
Less: Current Portion, Net	(683)	(245)
Total Long-Term Debt, Net	$40,342	$ 38,749

HSBC Term Loan

On June 26, 2018, the Company's UK subsidiary, Staffing 360 Solutions Limited (the "S360 Ltd"), entered into a term loan agreement (the "Term Loan") with HSBC Bank plc ("HSBC plc"). The Term Loan was drawn down on June 28, 2018 in an original principal amount of £1,550 ($2,047) to fund the upfront cash consideration of the Clement May acquisition. The Term Loan matures on June 28, 2021, unless otherwise accelerated or terminated earlier. The interest rate on the Term Loan is 2.35% over the base rate of 0.5%, which is subject to periodic adjustment, and is payable in monthly installments of principal and interest. The obligations of S360 Ltd under the term Loan are secured by fixed and floating charges in favor of HSBC plc on all of S360 Ltd and its UK subsidiaries' assets, undertakings, accounts receivable and certain other assets pursuant to the terms of the Term Loan agreement.

Non-interest bearing convertible note - April 11, 2017

On April 11, 2017, the Company entered into a non-interest bearing convertible note for $477, whereby the Company received cash of $400, maturing in October 2017. The Company paid this in full on September 18, 2017.

STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

Jackson Investment Group Term Loan Note #2 – Related Party

On April 5, 2017, the Company amended the note and warrant purchase agreement and entered into a second subordinated secured note for $1,650. Under the terms of this amended agreement, the Company issued to Jackson 59,397 shares of common stock, with an additional 74,184 shares of common stock that was issued after obtaining shareholder approval for issuance of shares to Jackson in excess of the 19.99% limit in June 2017. Also on April 5, 2017, the Company amended the Warrant to allow Jackson to purchase up to an additional 275,508 shares of common stock, modified the initial exercise price of the Warrant to $5.00 per share and modified the conversion price of accrued interest on the note issued to Jackson in January 2017 to $7.50. The Warrant was also amended to increase the amount of common stock issuable to Jackson pursuant to the anti-dilution clause contained therein. The second note accrues interest on the principal amount at a rate of 6% per annum and has a maturity date of June 8, 2019; however, in the event the Company satisfied all of its outstanding obligations with Midcap Financial Trust, the maturity date would have been adjusted to July 25, 2018. No interest or principal is payable on the second note until maturity. At any time during the term of the second note, upon notice to Jackson, the Company may also, at its option, redeem all or some of the then outstanding principal amount of the note by paying to Jackson an amount not less than $100 of the outstanding principal (and in multiples of $100), plus any accrued but unpaid interest and liquidated damages and other amounts due under the note. The second note’s principal is not convertible into shares of common stock; however, 50% of the accrued interest on the second note can be converted into shares of common stock, at the sole election of Jackson at maturity or in the event of a prepayment by the Company, at a conversion price equal to $7.50 per share. The proceeds of this transaction were used to redeem the remaining shares and conversion rights of the Series D Preferred Stock. The Company has accounted for these warrants as a liability under ASC 815-40 due to certain anti-dilution protection provisions. The Company has recorded a liability of $1,426 at December 30, 2017. One April 25, 2018, the Company and Jackson amended the Warrant to remove the anti-dilution clauses. Refer to Note 6 for further details.

8% Convertible Note (July 8, 2015) and 8% Convertible Note (February 8, 2016)

On January 3, 2017, the Company entered into an amendment agreement pursuant to which, the parties refinanced an aggregate amount of $2,688 of indebtedness and extended all amortization payments for the two 8% convertible notes dated July 8, 2015 and February 8, 2016 (collectively, the “Amendment”) to October 1, 2018, which was approximately 21 months from the date of the refinancing.

The Amendment had a new face value of $3,126, and an 8% interest rate per annum, with no interest payments due until October 1, 2017, payable quarterly thereafter, and an overall term of 21 months with principal due at maturity. The Amendment was convertible into shares of common stock at a price of $3.00 per share ($15 per shares after stock

split in Q1 2018) at holder's election, and the holder agreed to eliminate the 20% pre-payment penalty for an early redemption. In connection with the refinancing, the Company issued the holder 120,000 shares of common stock, valued at $498. The Amendment resulted in the extinguishment of the old notes of $2,688 and recording of the new debt and debt issue costs. The Company recorded a $870 loss upon extinguishment. On January 26, 2017, the Amendment was paid in full resulting a loss of $498.

Series B Bonds

The balance of $50 was paid in full in April 2017.

NOTE 6 – EQUITY

Common Stock

The Company issued the following shares of common stock during the six month period ended June 30, 2018:

Shares issued to/for:	Number of common shares issued	Fair Value of shares issued	Fair Value at Issuance (minimum and maximum per share)	
At-the-Market Facility	237,232	$ 629	$ 1.61	$ 3.59
Employees	85,000	137	1.61	1.61
Consultants	15,522	48	1.50	3.42
Acquisition	15,000	21	1.38	1.38
Board and Committee members	9,800	24	1.74	3.25
Reverse stock split (rounding up shares)	426	-	-	-
	362,980	$ 859		

Subsequent to June 30, 2018, the Company sold 400,000 shares of common stock through its at-the-market facility at a value of $1,449, and granted 5,600 shares of common stock valued $8 to the board of directors.

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STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands, except share, per share and stated value per share)

(UNAUDITED)

Restricted Shares

The Company has issued shares to employees and board and committee members under its 2015 Omnibus Incentive Plan and 2016 Omnibus Incentive Plan. Under these plans, the shares are restricted for a period of three years from issuance. As of June 30, 2018, the Company has a total of 565,932 shares unvested issued to employees and Board and committee members. In accordance with ASC 718, Compensation – Stock Compensation, the Company recognizes stock based compensation from restricted stock based upon the fair value of the award at issuance over the vesting term on a straight-line basis. The fair value of the award is calculated by multiplying the number of restricted shares by the Company’s stock price on the date of issuance. The impact of forfeitures has historically been immaterial to the financial statements. The Company recorded compensation expense associated with these restricted shares of $235, $196, $480 and $369, for the periods ended Q2 2018, Q2 2017, Q2 2018 YTD and Q2 2017 YTD, respectively.

Stock Options

The Company recorded share based payment expense of $53, $105, $135 and $198 for the periods ended Q2 2018, Q2 2017, Q2 2018 YTD and Q2 2017 YTD, respectively.

Convertible Preferred Shares

Series A Preferred Stock – Related Party

In the period ended Q2 2018 YTD and Q2 2017 YTD, the Company paid $100 and $0, respectively, in dividends to its Series A preferred stock holders. At July 1, 2017, the Company has accrued $100 with respect to Series A dividends payable to preferred stock holders.

Series D Preferred Stock

The Series D Preferred Stock contained beneficial conversion features; a portion was quantifiable at the date of issuance in the amount of $615, which was recognized immediately due to the immediate convertibility of the Series D Preferred Stock and that it had no true redemption date. The additional contingent beneficial conversion feature was quantifiable only at the date of each subsequent conversion. Both beneficial conversion features represent additional value to the holders. As such, they represent a dividend on the Series D Preferred Stock and recorded as a Deemed Dividend. These Deemed Dividends are presented on the Statement of Operations for purposes of calculation Earnings Per Share only and have no net impact on Shareholders’ Deficit. Deemed Dividends recorded were $0 and $2,009 for Q2 2018 YTD and Q2 2017 YTD, respectively.

On April 5, 2017, the Company entered into an agreement with holders of the Series D Preferred shares to redeem the remaining 62 shares of Series D Preferred Stock and terminate all future conversion rights, in return for $1,500 in cash and 60,000 shares of common stock.

Warrants

The Company had accounted for the warrants issued to Jackson as a liability under ASC 815-40 due to certain anti-dilution protection provisions. The warrants issued to Jackson are considered to be Level 3 liabilities under ASC 820. On April 25, 2018, the Company and Jackson amended the Warrant to remove the anti-dilution clauses. No economic terms were adjusted. These clauses were the basis for recording the warrants as a liability. Therefore, upon execution of this amendment, the Company recorded a mark-to-market gain and reclass the remaining liability to Additional paid-in capital. The Company recorded a change in fair value of the warrant liability of $341, $287, $879 and $195 in Q2 2018, Q2 2017, Q2 2018 YTD and Q2 2017 YTD, respectively, using Black-Scholes valuation model.

NOTE 7 – COMMITMENTS AND CONTINGENCIES

Earn-out Liabilities and Stock Value Guarantees

Pursuant to the acquisition of Control Solutions International, Inc. (“CSI”) on November 4, 2013, the purchase price included monthly cash payments to the former owner and shareholder of CSI for performance-based compensation equal to 20% of CSI’s consolidated gross profit from the date of closing through the end of the sixteenth quarter following the date of closing not to exceed a total of $2,100. During Q2 2018 and Q2 2017, the Company paid $0 and $24, respectively, towards the earn-out liability. During Q2 2018 YTD and Q2 2017 YTD, the Company paid $15 and $48, respectively, towards the earn-out liability No further payments are due.

Pursuant to the acquisition of The JM Group on November 5, 2015, the purchase price includes a cash payment to the shareholders for performance-based compensation of (a) £850 if the gross profit for the 12 month period ending on the anniversary date of the date of

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STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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completion (the "Anniversary TTM Gross Profit") is equal to 90% or more of the gross profit for the twelve months ending October 31, 2015 (the "Completion TTM Gross Profit"); or (b) if the Anniversary TTM Gross Profit is less than 90% of the Completion TTM Gross Profit, a sum equal to £850 multiplied by the Anniversary TTM Gross Profit/Completion TTM Gross Profit. The Company recorded the maximum contingent liability amount of £850 ($1,180). At December 31, 2016, the remaining balance was $1,026 and was recorded in other current liabilities. While unpaid, the balance accrued interest at 10.25% per annum. The balance was paid in full in January 2017.

Pursuant to the acquisition of Clement May on June 28, 2018, the purchase price includes an earnout payment of up to £500 to be paid on or around December 28, 2018; and deferred consideration of £350, the amount to be calculated and paid pursuant to the Share Purchase Agreement, to be paid on or around June 28, 2019.

Legal Proceedings

NewCSI, Inc. vs. Staffing 360 Solutions, Inc.

On May 22, 2014, NewCSI, Inc. ("NewCSI"), the former owners of Control Solutions International, filed a complaint in the United States District Court for the Western District of Texas, Austin Division, against the Company arising from the terms of the Stock Purchase Agreement dated August 14, 2013 between the Company and NewCSI. NewCSI claims that the Company breached a provision of the Stock Purchase Agreement ("SPA § 2.7") that required the Company to calculate and pay to NewCSI 50% of certain "Deferred Tax Assets" within 90 days after December 31, 2013, subject to certain criteria. The Complaint sought payment of the amount allegedly owed under SPA § 2.7 and acceleration of earn-out payments provided for in the Stock Purchase Agreement of $1,400, less amounts paid to date, and attorneys' fees.

On December 31, 2014, NewCSI filed an amended complaint to which NewCSI added an additional count asserting an "Adjustment Event" had occurred requiring an acceleration of earn-out payments provided for in the CSI Stock Purchase Agreement of $2,100, less amounts paid as of December 31, 2014 totaling $429 (balance of $1,671 at December 31, 2014), should the Company or CSI "be unable, or admit in writing its inability, to pay its debts as they mature." The Company responded denying the material allegations and interposing numerous affirmative defenses, including that the earn-out liability was fully expensed at the time of the acquisition and fully accrued for on the Company's balance sheet as part of the purchase accounting at the time of the acquisition. A the trial was held May 18-20, 2015. On May 20, 2015, the jury rendered a verdict, finding that the Company had not complied with SPA § 2.7 and owed $154, but that NewCSI had not proven that the Company or CSI had become unable to pay debts as they came due.

On June 3, 2015, NewCSI filed a Motion for Entry of Judgment as Matter of Law seeking entry of a judgment in the amount of $154, plus accelerated earn-out payments in the amount of $1,152, plus statutory interest. NewCSI did not

challenge the jury verdict on the ability to pay issue. Also on June 3, 2015, the Company filed a Motion for Entry of Judgment as a Matter of Law seeking entry of judgment against NewCSI on the jury's finding that the Company had not complied with SPA § 2.7, or, in the alternative, for a reduction of damages to $154 and to hold that NewCSI may not be awarded accelerated earn-out payments as that would result in an illegal penalty.

On October 21, 2015, judgment was entered in this action in favor of NewCSI and against the Company in the amount of $1,307, plus pre-judgment interest, post-judgment interest, and costs.

On January 26, 2016, the District Court set the bond in respect of the NewCSI litigation at $1,384. The Company has filed a notice of appeal to the United States Court of Appeals for the Fifth Circuit ("Appellate Court") seeking reversal of the judgment and posted a supersedeas bond to stay the execution of the judgment pending appeal. On April 18, 2016, the Court granted the NewCSI shareholders' request for payment of attorneys' fees, but reserved judgment on the amount of fees to award pending the outcome of the Company's appeal. On November 3, 2016, oral arguments for the appeal were heard and on July 26, 2017, the Appellate Court affirmed the trial Court's decision but left the legal fee award open for determination by further proceedings in the trial court. On August 29, 2017 the surety company released the supersedeas bond to the New CSI shareholders' counsel, which was amount was approximately $5 less than the judgment amount with accumulated interest. Payment of this remaining balance has been made by the Company.

On September 29, 2017 NewCSI filed a Supplemental Motion in the United States District Court for the Western District of Texas, Austin Division, seeking $629 in attorneys' fees. The Company opposed this motion but the magistrate judge issued a report and recommendation on November 17, 2017 recommending an award of fees in the amount of $606. The Company filed an objection with the trial judge to the magistrate's report and recommendation. On May 30, 2018 the trial judge issued an order adopting the report and recommendation of the magistrate judge and awarding NewCSI the amount of $606 in legal fees, plus interest at the statutory rate of 2.27% per annum. The Company paid $606 in full settlement of this matter in June 2018.

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Staffing 360 Solutions, Inc. v. Former Officers of Staffing 360 Solutions, Inc.

On November 13, 2015, in a separate proceeding, Staffing 360 initiated an arbitration before JAMS entitled Staffing 360 Solutions, Inc. v. Former Officers of Staffing 360 Solutions, Inc., against three officers of Staffing 360, each a former Staffing 360 officer and employee. In its demand for arbitration and statement of claim, Staffing 360 alleged that these individuals breached their employment agreements with Staffing 360 and the fiduciary duties each owed to the Company. The three respondents responded with a counterclaim alleging wrongful termination and have moved to dismiss the arbitration, as well as moved for severance in relation to the remainder of their contracts. On July 20, 2016, the arbitrator decided in favor of both of the respondents' motions. Further on September 21, 2016 the arbitrator rendered the final award, which was set at $1,433. The former officers brought an action in US District Court in New York City under the caption Dealy et al., v. Staffing 360 Solutions, Inc., requesting that the Court convert this arbitration award into a judgment. On July 11, 2017, the Court entered an order confirming the arbitrator's award and granting judgement against the Company. In August 2017, the Company paid $1,582 in full satisfaction of this matter.

NOTE 8 – SEGMENTS

The Company generated revenue and gross profit by segment as follows:

	Q2 2018	Q2 2017	Q2 2018 YTD	Q2 2017 YTD
Commercial Staffing - US	$23,549	$23,308	$44,945	$45,719
Professional Staffing - US	14,066	12,232	28,733	23,928
Professional Staffing - UK	22,112	6,577	41,840	13,182
Total Revenue	$59,727	$42,117	$115,518	$82,829
Commercial Staffing - US	$3,917	$4,288	$7,815	$8,305
Professional Staffing - US	4,214	2,245	8,199	4,117
Professional Staffing - UK	3,751	1,391	7,449	2,828
Total Gross Profit	$11,882	$7,924	$23,463	$15,250
Selling, general and administrative expenses	$(11,030)	$(6,439)	$(22,218)	$(13,562)
Depreciation and amortization	(712)	(760)	(1,510)	(1,520)
Interest expense	(1,951)	(580)	(3,906)	(1,082)
Amortization of debt discount and deferred financing costs	(115)	(839)	(237)	(1,398)
Loss on extinguishment of debt, net	—	—	—	(1,368)
Change in fair value of warrant liability	341	287	879	195
Gain from sale of business	238	—	238	—

Re-measurement loss on intercompany note	(721)	—	(146)	—
Other (expense) income, net	(9)	(23)	241	(19)
Loss Before Provision for Income Tax	$(2,077)	$(430)	$(3,196)	$(3,504)

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The following table disaggregates revenues by segments:

Q2 2018	Commercial Staffing - US	Professional Staffing - US	Professional Staffing - UK	Total
Permanent Revenue	$43	$ 1,666	$ 1,180	$2,889
Temporary Revenue	23,506	12,400	20,932	56,838
Total	$23,549	$ 14,066	$ 22,112	$59,727

Q2 2017	Commercial Staffing - US	Professional Staffing - US	Professional Staffing - UK	Total
Permanent Revenue	$12	$ 153	$ 629	$794
Temporary Revenue	23,296	12,079	5,948	41,323
Total	$23,308	$ 12,232	$ 6,577	$42,117

Q2 2018 YTD	Commercial Staffing - US	Professional Staffing - US	Professional Staffing - UK	Total
Permanent Revenue	$115	$ 3,173	$ 2,395	$5,683
Temporary Revenue	44,830	25,560	39,445	109,835
Total	$44,945	$ 28,733	$ 41,840	$115,518

Q2 2017 YTD	Commercial Staffing - US	Professional Staffing - US	Professional Staffing - UK	Total
Permanent Revenue	$44	$ 279	$ 1,256	$1,579
Temporary Revenue	45,675	23,649	11,926	81,250
Total	$45,719	$ 23,928	$ 13,182	$82,829

As of June 30, 2018 and December 30, 2017, the Company has assets in the U.S., the U.K. and Canada as follows:

	June 30, 2018	December 30, 2017
United States	$42,971	$ 53,814
United Kingdom	39,948	32,861
Canada	51	73
Total Assets	$82,970	$ 86,748

NOTE 9 – ACQUISITIONS

In accordance with ASC 805, the Company accounts for acquisitions using the purchase method under which the acquisition purchase price is allocated to the assets acquired and liabilities assumed based upon their respective fair values. The Company utilizes management estimates and, in some instances, may retain the services of an independent third-party valuation firm to assist in determining the fair values of assets acquired, liabilities assumed and contingent consideration granted. Such estimates and valuations require the Company to make significant assumptions, including projections of future events and operating performance.

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In connection with the acquisition of Clement May, the Company recorded the following identifiable intangible assets, based on preliminary valuation.

	Clement May
Goodwill	$ 1,545
Intangible assets	
Tradenames	$ 470
Non-compete	273
Customer Relationships	451
	$ 1,194

Goodwill of Clement May is included in the Company's Professional-UK reportable segment.

These identified intangible assets are being amortized on a straight-line basis over their weighted average estimated useful life of 8.4 years. The Company acquired a total of $14,305 in receivables and fair value of these receivables equals the contract value; and recorded contingent consideration associated with Clement May of £850 ($1,122).

The following table summarizes the final allocation of the purchase price to the estimated fair values of net assets acquired at the date of the acquisition:

	Clement May
Purchase price	$ 3,543
Less:	
Net assets acquired	$ (804)
Intangible assets	(1,194)

Goodwill	$1,545

The Company recorded a total of $105 in third party expenses associated with consummating this acquisition, which are included in Selling, general and administrative expenses, excluding depreciation and amortization stated on the Consolidated Statement of Operations.

The following unaudited pro forma consolidated results of operation have been prepared, as if the acquisition of FirstPro and CBS Butler had occurred as of June 1, 2016, and acquisition of Clement May acquired on January 1, 2017.

	Q2 2018	Q2 2017	Q2 2018 YTD	Q2 2017 YTD
Revenues	$71,089	$70,280	$139,545	$140,668
Net loss from continuing operations	(1,779)	(780)	(2,911)	(4,296)

NOTE 10 – OTHER RELATED PARTY TRANSACTIONS

In addition to the Series A Preferred Shares and Notes issued to Jackson, the following are other related party transactions:

Board and Committee Members

The Company had the following activity with its Board and Committee Members:

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	Q2 2018				Q2 2017			
	Cash Compensation	Shares Issued	Value of Shares Issued	Compensation Expense Recognized	Cash Compensation	Shares Issued	Value of Shares Issued	Compensation Expense Recognized
Dimitri Villard	$19	1,400	$ 2	$ 20	$19	5,200	$ 24	$ 17
Jeff Grout	19	1,400	2	20	19	5,200	24	17
Nick Florio	19	1,400	2	20	19	5,200	24	17
Alicia Barker	19	1,400	2	-	-	-	-	-
	$76	5,600	$ 8	$ 60	$57	15,600	$ 72	$ 51

	Q2 2018 YTD				Q2 2017 YTD			
	Cash Compensation	Shares Issued	Value of Shares Issued	Compensation Expense Recognized	Cash Compensation	Shares Issued	Value of Shares Issued	Compensation Expense Recognized
Dimitri Villard	$38	2,800	$ 7	$ 40	$31	13,500	$ 55	$ 34
Jeff Grout	38	2,800	7	40	31	13,500	55	34
Nick Florio	38	2,800	7	40	31	13,700	55	34
Alicia Barker	19	1,400	2	-	-	-	-	-
	$133	9,800	$ 23	$ 120	$93	40,700	$ 165	$ 102

The Company has no balances within accrued in accounts payable and accrued expenses – related parties account as of June 30, 2018.

The Briand Separation Agreement The Company's former employee, board member and officer resigned from his positions with the Company and subsidiaries. The Company entered into an agreement (the "Briand Separation Agreement") with Mr. Briand dated December 21, 2017, with an effective date ("Separation Date") of January 31, 2018, pursuant to which Mr. Briand may provide advisory services, if requested by the Company, through the effective date. The Company paid $18 in Q2 2018 to Mr. Briand as part of this separation agreement. The accrued balance due to Mr. Briand as of June 30, 2018 is $300.

Appointment of Officers

On March 28, 2018, the Company appointed Alicia Barker to fill the Class II director vacancy created by the departure of Mr. Briand earlier this year, such appointment to be effective April 1, 2018. Ms. Barker joined the company's board of directors as an independent director and serves on the Board's Compensation Committee and on the Nominating and Corporate Governance Committee.

Effective July 1, 2018, the Company entered into an Employment Agreement with Alicia Barker that appointed her as the Company's Chief Operating Officer. Ms. Barker will continue as a member of the Company's board of directors, but effective with her appointment will no longer be a member of any Board committee, nor an independent member of the Board, bringing the number of independent directors to three of five Board members.

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NOTE 11 – SUPPLEMENTAL CASH FLOW INFORMATION

	Q2 2018 YTD	Q2 2017 YTD
Cash paid for:		
Interest	$3,360	$827
Income taxes	98	130
Non-Cash Investing and Financing Activities:		
Deferred purchase price of UK factoring facility	$3,585	$—
Shares issued in connection with acquisition of business	21	—
Shares issued in connection with convertible note	—	498
Shares issued in connection with Jackson term loan	—	1,198
Shares issued in connection with Series D payoff	—	208
Warrants issued in connection with Jackson term loan	—	1,614
Deemed Dividends		2,009

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

The following discussion and analysis of our results of operations and financial condition should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report. This section includes a number of forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that reflect our current views with respect to future events and financial performance. All statements that address expectations or projections about the future, including, but not limited to, statements about our plans, strategies, adequacy of resources and future financial results (such as revenue, gross profit, operating profit, cash flow), are forward-looking statements. Some of the forward-looking statements can be identified by words like "anticipates," "believes," "expects," "may," "will," "can," "could," "should," "intends," "project," "predict," "plans," "estimate "possible," "potential," "would," "seek," and similar references to future periods. These statements are not guarantees of future performance and involve a number of risks, uncertainties and assumptions that are difficult to predict. Because these forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond our control or are subject to change, actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements. Important factors that could cause actual results to differ materially from these forward-looking statements include, but are not limited to: negative outcome of pending and future claims and litigation; our ability to access the capital markets by pursuing additional debt and equity financing to fund our business plan and expenses on terms acceptable to us or at all; and our ability to comply with our contractual covenants, including in respect of our debt; potential cost overruns and possible rejection of our business model and/or sales methods; weakness in general economic conditions and levels of capital spending by customers in the industries we serve; weakness or volatility in the financial and capital markets, which may result in the postponement or cancellation of our customers' capital projects or the inability of our customers to pay our fees; delays or reductions in U.S. government spending; credit risks associated with our customers; competitive market pressures; the availability and cost of qualified labor; our level of success in attracting, training and retaining qualified management personnel and other staff employees; changes in tax laws and other government regulations, including the impact of health care reform laws and regulations; the possibility of incurring liability for our business activities, including, but not limited to, the activities of our temporary employees; our performance on customer contracts; and government policies, legislation or judicial decisions adverse to our businesses. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We assume no obligation to update such statements, whether as a result of new information, future events or otherwise, except as required by law. We recommend readers to carefully review the reports and documents we file from time to time with the Securities and Exchange Commission ("SEC"), particularly our Quarterly Reports on Form 10-Q and our Current Reports on Form 8-K.

Overview

We are incorporated in the State of Delaware. As a rapidly growing public company in the international staffing sector, our high-growth business model is based on finding and acquiring suitable, mature, profitable, operating, U.S. and U.K. based staffing companies. Our targeted consolidation model is focused specifically on the Professional Sector and Commercial Sector disciplines.

Business Model, Operating History and Acquisitions

We are a high-growth international staffing company engaged in the acquisition of U.S. and U.K. based staffing companies. As part of our consolidation model, we pursue a broad spectrum of staffing companies supporting primarily the Professional and Commercial Sectors. Our typical acquisition model is based on paying consideration in

the form of cash, stock, earn-outs and/or promissory notes. In furthering our business model, the Company is regularly in discussions and negotiations with various suitable, mature acquisition targets. Since November 2013, the company has completed nine acquisitions.

All share numbers in this section have been adjusted for the one-for-five reverse stock split effective at 5:00 p.m. New York time on January 3, 2018.

On September 15, 2017, Staffing 360 Georgia, LLC ("Staffing Georgia"), a wholly-owned subsidiary of the Company entered into an asset purchase agreement with Firstpro Inc. ("FPI"), Firstpro Georgia, LLC ("FPL"), and certain individuals, pursuant to which the FPI and FPL sold substantially all of their assets to Staffing Georgia ("Firstpro Acquisition"). The purchase price in connection with the Staffing Georgia, was $8,000, of which, (a) $4,500 was paid at closing, (b) $825 is payable in quarterly installments of $75 beginning on October 1, 2017, and (c) $2,675 is payable annually in three equal installments beginning on September 15, 2018.

On September 15, 2017, the Company and Longbridge Recruitment 360 Limited ("Longbridge"), a wholly-owned subsidiary of the Company, entered into an agreement ("Share Purchase Agreement") with the holders of share capital of CBS Butler Holdings Limited ("CBS Butler") and an agreement ("Option Purchase Agreement") with the holders of outstanding options of CBS Butler, pursuant to which the holders of the share capital of CBS Butler and holders of outstanding options of CBS Butler sold all of their shares and options of CBS Butler to Longbridge (the "CBS Butler Acquisition"), in exchange for (i) an aggregate cash payment of £13,810, (ii) an aggregate

STAFFING 360 SOLUTIONS, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(All amounts in thousands, except share, par values and stated values)

of 100,000 shares of the Company's common stock, (iii) an earn-out payment of up to £4,214 (payable in October 2018 based upon CBS Butler's operating performance during the period September 1, 2017 through August 31, 2018), and (iv) deferred consideration of £150 less the aggregate amount of each CBS Butler Shareholder's portion of the net asset shortfall amount, if any, as determined pursuant to the Share Purchase Agreement and the Option Purchase Agreement.

To finance the above transactions, the Company entered into an agreement with Jackson Investment Group, LLC ("Jackson") on September 15, 2017. The Company, as borrower, and certain domestic subsidiaries of the Company, as guarantors, entered into an amended and restated note purchase agreement with Jackson, as lender (the "A&R Note Purchase Agreement"), pursuant to which Jackson made a senior debt investment of $40,000 in the Company in exchange for a senior secured note in the principal amount of $40,000 (the "Jackson Note"). The proceeds of the sale of the secured note were used to (i) repay the existing subordinated notes previously issued to Jackson in the aggregate principal amount of $11,165, (ii) to fund the upfront cash portion of the purchase price consideration of the Firstpro Acquisition and the CBS Butler Acquisition, (iii) to repay almost all other outstanding indebtedness of the Company and (iv) general working capital purposes. The maturity date of the Jackson Note is September 15, 2020. The Jackson Note will accrue interest at 12% per annum, due quarterly on January 1, April 1, July 1 and October 1 in each year, with the first such payment due on January 1, 2018. Interest on any overdue payment of principal or interest due under the Jackson Note will accrue at a rate per annum that is 5% in excess of the rate of interest otherwise payable thereunder. The Company may prepay the amounts due on the Jackson Note in whole or in part from time to time, without penalty or premium, subject to the conditions set forth in the A&R Note Purchase Agreement, and such prepayments, depending on the timing of the prepayments, may result in a discount on the principal amount to be prepaid as set forth in the A&R Note Purchase Agreement. The Company paid a closing fee of $1,000 in connection with its entry into the A&R Note Purchase Agreement and agreed to issue 450,000 shares of the Company's common stock as a closing commitment fee.

Clement May Acquisition

On June 28, 2018, the Company and Longbridge Recruitment 360 Limited ("Longbridge"), a wholly-owned subsidiary of the Company, entered into share purchase agreements ("Share Purchase Agreements") of the share capital of Clement May Limited ("CML"). Consideration for the acquisition of all the shares was (i) an aggregate cash payment of £1,550 ($2,047), (ii) 15,000 shares of the Company's common stock, (iii) the assignment of certain outstanding debt owed to the CML Majority Holder to the Principal as set forth in that Share Purchase Agreement, (iv) an earn-out payment of up to £500, the amount to be calculated and paid pursuant to that Share Purchase Agreement due on or around December 28, 2018, and (v) deferred consideration of £350, to be paid on or around June 28, 2019, depending on the satisfaction of certain conditions set forth in that Share Purchase Agreement. To finance the above transaction, the Company entered into a term loan with HSBC Bank plc. Refer to Note 9 for further details.

PeopleServe Disposition

On June 6, 2018, the Company divested the stock of PeopleServe Inc., and PeopleServe PRS, Inc. for a total consideration of $1,502, net of $567 that was remitted back to the buyer on July 31, 2018 in connection with a net working capital true up. The Company recorded a gain of $238 from sale of business.

For three-month periods ended June 30, 2018 and July 1, 2017

	Q2 2018	% of Revenue	Q2 2017	% of Revenue	Growth
Revenue	$59,727	100.0 %	$42,117	100.0 %	41.8 %
Direct cost of revenue	47,845	80.1 %	34,193	81.2 %	39.9 %
Gross profit	11,882	19.9 %	7,924	18.8 %	49.9 %
Operating expenses	11,742	19.7 %	7,199	17.1 %	63.1 %
Income from operations	140	0.2 %	725	1.7 %	(80.7)%
Other expenses	(2,217)	(3.7)%	(1,155)	(2.7)%	91.9 %
Benefit from (Provision for) income taxes	233	0.4 %	(2)	(0.0)%	(11750.0)%
Net loss	$(1,844)	(3.1)%	$(432)	(1.0)%	326.9 %

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(All amounts in thousands, except share, par values and stated values)

Revenue

For Q2 2018, revenue increased by 41.8% to $59,727 as compared to $42,117 for Q2 2017. Of that growth, $20,147 was from the acquisitions of CBS Butler, Firstpro, and Clement May, and $427 was from favorable foreign currency translation. This was partially offset by a decline of $1,588 due to PeopleServe and an organic decline of $1,376 from the remaining core business. Temporary contractor revenue declined $1,153 and permanent placement declined $223.

Revenue in Q2 2018 was comprised of $56,838 of temporary contractor revenue and $2,889 of permanent placement revenue, compared with $41,323 and $794 for Q2 2017, respectively

Direct cost of revenue, Gross profit and gross margin

Direct cost of services includes the variable cost of labor and various non-variable costs (e.g., workers' compensation insurance) relating to employees (temporary and permanent) as well as sub-contractors and consultants. For Q2 2018, direct cost of revenue was $47,845, an increase of 39.9% from $34,193 in Q2 2017, compared with revenue growth of 41.8%.

Gross profit for Q2 2018 was $11,882, and increase of 49.9% over $7,924 for Q2 2017, representing gross margin of 19.9% and 18.8% for each period, respectively. Gross profit growth was attributed to the impact of acquisitions. This was partly offset by lower savings from workers' compensation insurance versus the savings realized in the corresponding period in 2017, organic decline on lower permanent placement revenue, and divestiture of the lower margin PeopleServe business.

Operating expenses

Operating expenses for Q2 2018 was $11,742, an increase of 63.1% over $7,199 for Q2 2017. Of that increase, 52.7% can be attributed to acquisition of CBS Butler, Firstpro, and Clement May and the remaining increase is primarily stemming from other non-recurring costs and other costs associated with acquisitions, capital raising, and non-cash charges or credits. This was partly offset by savings that are materializing which are attributable to synergies within the subsidiaries, cost savings initiatives, and PeopleServe divesture.

Other Expenses

Other expenses for Q2 2018 was $2,217, an increase of 91.9% from $1,155 in Q2 2017. For Q2 2018 compared with Q2 2017, other expenses primarily reflects higher interest of $1,370 driven mainly by the higher debt and cost of capital resulting from the refinancing in September 2017; a loss of $721 from remeasuring the Company's intercompany note; lower amortization of debt discount and deferred financing costs by $724 also attributable to the refinancing; a gain of $238 from the sale of PeopleServe and a higher gain of $54 from fair valuing warrants.

For the six-month periods ended June 30, 2018 and July 1, 2017

	Q2 2018 YTD	% of Revenue	Q2 2017 YTD	% of Revenue	Growth
Revenue	$115,518	100.0 %	$82,829	100.0 %	39.5 %
Direct cost of revenue	92,055	79.7 %	67,579	81.6 %	36.2 %
Gross profit	23,463	20.3 %	15,250	18.4 %	53.9 %
Operating expenses	23,728	20.5 %	15,082	18.2 %	57.3 %
(Loss) Income from operations	(265)	(0.2)%	168	0.2 %	(257.7)%
Other expenses	(2,931)	(2.5)%	(3,672)	(4.4)%	(20.2)%
Benefit from (Provision for) income taxes	81	0.1 %	(7)	(0.0)%	(1257.1)%
Net loss	$(3,115)	(2.7)%	$(3,511)	(4.2)%	(11.3)%

Revenue

Q2 2018 YTD revenue increased by 39.5% to $115,518 as compared to $82,829 for Q2 2017 YTD. Of that growth, $38,017 was from the acquisitions of CBS Butler, Firstpro, and Clement May and $1,242 was from favorable foreign currency translation. This was partially offset by a decline of $2,029 due to PeopleServe and an organic decline of $4,541 from the remaining core business. Organic temporary contractor revenue declined $4,169, partially due to a greater number of weather-related work stoppage days in Q1 2018, and organic permanent placement declined $372.

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Revenue in Q2 2018 YTD was comprised of $109,835 of temporary contractor revenue and $5,683 of permanent placement revenue, compared with $81,250 and $1,579 for Q2 2017 YTD, respectively.

Direct cost of revenue, Gross profit and gross margin

Direct cost of services includes the variable cost of labor and various non-variable costs (e.g., workers' compensation insurance) relating to employees (temporary and permanent) as well as sub-contractors and consultants. For Q2 2018 YTD, direct cost of revenue was $92,055, an increase of 36.2% from $67,579 in Q2 2017 YTD, compared with revenue growth of 39.5%.

Gross profit for Q2 2018 YTD was $23,463, an increase of 53.9% over $15,250 for Q2 2017 YTD, representing gross margin of 20.3% and 18.4% for each period, respectively. Gross profit growth was attributed to the impact of acquisitions. This was partly offset by lower savings from workers' compensation insurance versus the savings realized in the corresponding period in 2017, organic decline on lower permanent placement revenue, and the divestiture of the lower margin PeopleServe business.

Operating expenses

Operating expenses for Q2 2018 YTD was $23,728, an increase of 57.3% over $15,082 for Q2 2017 YTD. Of that increase, 50% can be attributed to acquisition of CBS Butler, Firstpro, and Clement May and the remaining increase is primarily stemming from other non-recurring costs and other costs associated with acquisitions, capital raising, and non-cash charges or credits. This was partly offset by savings that are materializing which are attributable to synergies within the subsidiaries, cost savings initiatives, PeopleServe divesture and higher commissions on the higher gross profit.

Other Expenses

Other expenses for Q2 2018 YTD was $2,931, a decrease of 20.2% from $3,672 in Q2 2017 YTD. For Q2 2018 YTD compared with Q2 2017 YTD, other expenses primarily reflects higher interest of $2,824 driven mainly by the higher debt and cost of capital resulting from the refinancing in September 2017; lower amortization of debt discount and deferred financing costs by $1,161 also attributable to the refinancing; a loss on extinguishment of debt in Q2 2017 YTD of $1,368 attributable to the refinancing of convertible notes in January 2017, with no corresponding loss in Q2 2018 YTD; a higher gain of $684 from fair valuing warrants in; a gain of $238 from the sale of PeopleServe; a loss of $146 from remeasuring the Company's intercompany note; and, other income of $260 primarily from investment income on the Company's workers' compensation collateral.

Non-GAAP Measures

To supplement our consolidated financial statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"), we also use non-GAAP financial measures and Key Performance Indicators ("KPIs") in addition to our GAAP results. We believe non-GAAP financial measures and KPIs may provide useful information for evaluating our cash operating performance, ability to service debt, compliance with debt

covenants and measurement against competitors. This information should be considered as supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be comparable to similarly entitled measures reported by other companies.

We present the following non-GAAP financial measure and KPIs in this report:

Revenue and Gross Profit by Sector We use this KPI to measure the Company’s mix of Revenue and respective profitability between its two main lines of business due to their differing margins. For clarity, these lines of business are not the Company’s operating segments, as this information is not currently regularly reviewed by the chief operating decision maker to allocate capital and resources. Rather, we use this KPI to benchmark the Company against the industry.

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The following table details Revenue and Gross Profit by Sector:

	Q2 2018	Mix	Q2 2017	Mix	Q2 2018 YTD	Mix	Q2 2017 YTD	Mix
Commercial Staffing - US	$23,549	39%	$23,308	55%	$44,945	39%	$45,719	55%
Professional Staffing - US	14,066	24%	12,232	29%	28,733	25%	23,928	29%
Professional Staffing - UK	22,112	37%	6,577	16%	41,840	36%	13,182	16%
Total Revenue	$59,727		$42,117		$115,518		$82,829	
Commercial Staffing - US	$3,917	33%	$4,288	54%	$7,815	33%	$8,305	54%
Professional Staffing - US	4,214	35%	2,245	28%	8,199	35%	4,117	27%
Professional Staffing - UK	3,751	32%	1,391	18%	7,449	32%	2,828	19%
Total Gross Profit	$11,882		$7,924		$23,463		$15,250	
Commercial Staffing - US	16.6 %		18.4 %		17.4 %		18.2 %	
Professional Staffing - US	30.0 %		18.4 %		28.5 %		17.2 %	
Professional Staffing - UK	17.0 %		21.1 %		17.8 %		21.5 %	
Total Gross Margin	19.9 %		18.8 %		20.3 %		18.4 %	

Adjusted EBITDA This measure is defined as net loss attributable to common stock before: interest expense, benefit from (provision for) income taxes; income (loss) from discontinued operations, net of tax; other (income) expense, net, in operating income (loss); amortization and impairment of identifiable intangible assets; impairment of goodwill; depreciation; operational restructuring and other charges; other income (expense), net, below operating income (loss); non-cash expenses associated with stock compensation; and charges the Company considers to be non-recurring in nature such as legal expenses associated with litigation, professional fees

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associated potential and completed acquisitions. We use this measure because we believe it provides a more meaningful understanding of the profit and cash flow generation of the Company.

	Q2 2018	Q2 2017	Q2 2018 YTD	Q2 2017 YTD
Net loss	$(1,844)	$(432)	$(3,115)	$(3,511)
Interest expense	1,951	580	3,906	1,082
Provision for income taxes	(233)	2	(81)	7
Depreciation and amortization (1)	827	1,599	1,747	2,918
EBITDA	$701	$1,749	$2,457	$496
Acquisition, capital raising and other non-recurring expenses (2)	997	(271)	1,844	260
Other non-cash charges (3)	291	322	663	618
Loss on extinguishment of debt, net	—	—	—	1,368
Change in fair value of warrant liability	(341)	(287)	(879)	(195)
Gain from sale of business	(238)	—	(238)	—
Re-measurement loss on intercompany note	721	—	146	—
Other income	9	23	(241)	19
Adjusted EBITDA	$2,140	$1,536	$3,752	$2,566
Trailing Twelve Months ("TTM") Adjusted EBITDA	$8,577	$5,404	$8,577	$5,404
Pro Forma TTM Adjusted EBITDA (4)	$10,794	N/A	$10,794	N/A
Gross Profit	$11,882	$7,924	$23,463	$15,250
Adjusted operating expenses (5)	$9,742	$6,388	$19,711	$12,684
Adjusted operating expenses percentage of gross profit	82.0 %	80.6 %	84.0 %	83.2 %

(1) Includes amortization included in other expenses.
(2) Acquisition, capital raising and other non-recurring expenses primarily relate to capital raising expenses, acquisition and integration expenses and legal expenses incurred in relation to matters outside the ordinary course of business.
(3) Other non-cash charges primarily relate to staff option and share compensation expense, expense for shares issued to directors for board services, and consideration paid for consulting services.
(4) Pro Forma TTM Adjusted EBITDA includes the Adjusted EBITDA of acquisitions for the period prior to the acquisition date.

(5) Adjusted operating expenses are defined as the operating expenses of the Company included in the definition of Adjusted EBITDA.

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Operating Leverage This measure is calculated by dividing the growth in Adjusted EBITDA by the growth in Gross Profit, on a trailing 12-month basis. We use this KPI because we believe it provides a measure of the Company's efficiency for converting incremental gross profit into Adjusted EBITDA.

	Twelve Months Ended	
	June 30, 2018	July 1, 2017
Gross Profit - TTM (Current Period)	$44,954	$31,596
Gross Profit - TTM (Prior Period)	31,596	29,670
Gross Profit - Growth	$13,358	$1,926
Adjusted EBITDA - TTM (Current Period)	$8,577	$5,404
Adjusted EBITDA - TTM (Prior Period)	5,404	4,493
Adjusted EBITDA - Growth	$3,173	$911
Operating Leverage	23.8 %	47.3 %

Leverage Ratio Calculated as Total Long-Term Debt, Net, gross of any Original Issue Discount, divided by Pro Forma Adjusted EBITDA for the trailing 12-months. We use this KPI as an indicator of the Company's ability to service its debt prospectively.

	June 30, 2018	December 30, 2017
Total Long-Term Debt, Net	$40,342	$ 38,749
Addback: Total Debt Discount and Deferred Financing Costs	1,022	1,251
Total Long-Term Debt	$41,364	$ 40,000
TTM Adjusted EBITDA	$8,577	$ 7,391
Pro Forma TTM Adjusted EBITDA	$10,794	$ 11,737
Pro Forma Leverage Ratio	3.8x	3.4x

Operating Cash Flow Including Proceeds from Accounts Receivable Financing calculated as net cash (used in) provided by operating activities plus net proceeds from accounts receivable financing. Because much of the

Company’s temporary payroll expense is paid weekly and in advance of clients remitting payment for invoices, operating cash flow is often weaker in staffing companies where revenue and accounts receivable are growing. Accounts receivable financing is essentially an advance on client remittances and is primarily used to fund temporary payroll. As such, we believe this measure is helpful to investors as an indicator of the Company’s underlying operating cash flow.

On February 8, 2018, CBS Butler, Longbridge and The JM Group, entered into a new arrangement with HSBC Invoice Finance (UK) Ltd (“HSBC”) which provides for HSBC to purchase the subsidiaries’ accounts receivable up to an aggregate amount of £11,500 across all three subsidiaries. The terms of the arrangement provide for HSBC to fund 90% of the purchased accounts receivable upfront and, a secured borrowing line of 70% of unbilled receivables capped at £1,000 (within the overall aggregate total facility of £11,500). Under ASU 2016-16, “Statement of Cash Flows (Topic 230, Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force, the upfront portion of the sale of accounts receivable is classified within operating activities, while the deferred purchase price portion (or beneficial interest), once collected, is classified within investing activities.

On June 28, 2018, the Company’s new subsidiary Clement May Limited (“CML”) entered into a new agreement for purchase of debt (“APD”) with HSBC, joining CBS Butler, Longbridge and The JM Group (collectively, with CML, the “Borrowers”) as “Connected Clients” as defined in the APD. The new Connected Client APDs carry an aggregate Facility Limit of £20,000 across all Borrowers and the CML APD matures on June 28, 2019, unless otherwise accelerated or terminated earlier. The obligations of the Borrowers are secured by a fixed charge and a floating charge on the Borrowers’ respective accounts receivable and are subject to cross-company guarantees among the Borrowers. In addition the secured borrowing line against unbilled receivables was increased to £1,500 for a period of 90 days.

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	Q2 2018 YTD	Q2 2017 YTD
Net cash provided by operating activities	$12,996	$2,104
Collection of UK factoring facility deferred purchase price	3,550	—
Repayments on accounts receivable financing	(18,813)	(2,709)
Net cash provided by (used in) operating activities including proceeds from accounts receivable financing	$(2,267)	$(605)

The Leverage Ratio and Operating Cash Flow Including Proceeds from Accounts Receivable Financing should be considered together with the information in the "Liquidity and Capital Resources" section, immediately below.

Liquidity and Capital Resources

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations, and otherwise operate on an ongoing basis. Historically, we have funded our operations through term loans, promissory notes, bonds, convertible notes, private placement offerings and sales of equity.

Our primary uses of cash have been for professional fees related to our operations and financial reporting requirements and for the payment of compensation, benefits and consulting fees. The following trends may occur as the Company continues to execute on its strategy:

- An increase in working capital requirements to finance organic growth,
- Addition of administrative and sales personnel as the business grows,
- Increases in advertising, public relations and sales promotions for existing and new brands as we expand within existing markets or enter new markets,
- A continuation of the costs associated with being a public company, and
- Capital expenditures to add technologies.

Our liquidity may be negatively impacted by the significant costs associated with our public company reporting requirements, costs associated with newly applicable corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002 and other rules implemented by the Securities and Exchange Commission. We expect all of these applicable rules and regulations could significantly increase our legal and financial compliance costs and increase the use of resources.

As of and for the period ended June 30, 2018, the Company had a working capital deficiency of $13,124, an accumulated deficit of $68,257, and a net loss of $3,115.

On September 15, 2017, the Company entered into the Jackson Note for $40,000. The proceeds of the sale of the secured note were used to (i) repay the existing subordinated notes previously issued to Jackson in the aggregate principal amount of $11,165, (ii) to fund a portion of the upfront cash portion of purchase price consideration of the Firstpro Acquisition and the CBS Butler Acquisition, (iii) repay substantially all other outstanding indebtedness of the Company and (iv) for general working capital purposes. The maturity date for the Jackson Note is September 15, 2020. The Jackson Note will accrue interest at 12% per annum, due quarterly on January 1, April 1, July 1 and October 1 in each year, with the first such payment due on January 1, 2018. Interest on any overdue payment of principal or interest due under the Jackson Note will accrue at a rate per annum that is 5% in excess of the rate of interest otherwise payable thereunder.

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To finance the CML acquisition, the Company entered into a term loan with HSBC Bank plc. The Term Loan was drawn down on June 28, 2018 in an original principal amount of £1,550 ($2,047). Refer to Note 9 for further details.

Management believes the Company is a going concern meaning it will meet its obligations for the next 12 months as of the date these financial statements are issued.

Operating activities

For Q2 2018 YTD, net cash provided by operations of $12,996 was primarily attributable changes in operating assets and liabilities totaling $14,672, non-cash adjustments of $1,439, partially offset by net loss of $3,115. Changes in operating assets and liabilities primarily relates to a decrease in accounts receivable of $12,919 (see further discussion below), increase in accounts payable and accrued expenses of $1,960 and other of $167, offset by decrease in interest payable – related party of $160, decrease in other long-term liabilities of $11, decrease in other current liabilities of $88, increase in prepaid expenses and other current assets of $57, increase in other assets of $58. Total non-cash adjustments of $1,439 primarily includes depreciation and amortization of intangible assets of $1,510, stock based compensation of $663, amortization of debt discounts and deferred financing of $237, foreign currency re-measurement on intercompany loan of $146; offset by gain on fair value of warrants of $879 and gain from sale of business of $238.

On February 8, 2018, CBS Butler, Longbridge and The JM Group, entered into a new arrangement with HSBC Invoice Finance (UK) Ltd ("HSBC") which provides for HSBC to purchase the subsidiaries' accounts receivable. Under ASU 2016-16, "Statement of Cash Flows (Topic 230, Classification of Certain Cash Receipts and Cash Payments, a consensus of the FASB Emerging Issues Task Force, the upfront portion of the sale of accounts receivable is classified within operating activities, while the deferred purchase price portion (or beneficial interest), once collected, is classified within investing activities.

For Q2 2017 YTD, net cash provided by operations of $2,104 was primarily attributable changes in operating assets and liabilities totaling $993 and non-cash adjustments of $4,622 offset by net loss of $3,511. Changes in operating assets and liabilities primarily relates to a decrease in accounts receivable of $2,281, a decrease in other assets of $295, an increase in other current and non current liabilities of $191; offset by a decrease accounts payable and accrued expenses of $1,201, an increase in prepaid expenses and other current asset of $269 and other of $304. Total non-cash adjustments of $4,622 primarily includes costs related to the extinguishment of debt of $1,368, amortization of debt discounts and deferred financing of $1,398, depreciation and amortization of $1,520, stock based compensation of $618; offset by gain on fair value of warrants of $195 and other of $87. During the period ended July 1, 2017, the Company used a portion of the proceeds from Jackson Investment Group, LLC to pay accounts payable and accrued expenses.

Investing activities

For Q2 2018 YTD, net cash flows provided by investing activities was $3,468, of which $3,550 is collection of the beneficial interest from HSBC (see discussion above), disposal of business of $1,968; offset by acquisition of business of $1,910, purchase of property and equipment of $140.

For Q2 2017 YTD, net cash flows used in investing activities is $126 which relates to purchase of property and equipment.

Financing activities

For Q2 2018 YTD, net cash flows used in financing activities totaled $16,676, of which $18,813 relates repayments on accounts receivable financing, net (primarily relates to settlement of the prior U.K. secured borrowing facilities in connection with the new HSBC facility (see discussion above)), $165 for deferred payments associated with the Firstpro acquisition and CSI earnout, $254 is for the repayment of the ABN AMRO term loan, dividends to related parties $100, third party financing costs of $20, offset by proceeds term loan $2,047 and proceeds from the At-market facility of $629.

For Q2 2017 YTD, net cash flows used in financing activities totaled $2,100, which is primarily related to accounts receivable financing net of $2,709, repayment of promissory notes $5,486, repayment of Series D Preferred Stock $1,500. payments made on earn outs of $1,075, third party financing costs of $938, repayment of bonds $50, offset by proceeds from term loan from related party of $9,050, proceeds from convertible notes of $400 and proceeds from the at the market facility of $208.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Refer to the Form 10-K filed with the SEC on March 29, 2018.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842). This guidance will be effective for public entities for fiscal years beginning after December 15, 2018 including the interim periods within those fiscal years. Early application is permitted. Under the new provisions, all lessees will report a right-of-use asset and a liability for the obligation to make payments for all leases with the exception of those leases with a term of 12 months or less. All other leases will fall into one of two categories: (i) Financing leases, similar to capital leases, which will require the recognition of an asset and liability, measured at the present value of the lease payments and (ii) Operating leases which will require the recognition of an asset and liability measured at the present value of the lease payments. Lessor accounting remains substantially unchanged with the exception that no leases entered into after the effective date will be classified as leveraged leases. For sale leaseback transactions, the sale will only be recognized if the criteria in the new revenue recognition standard are met. The Company is currently evaluating the impact of adopting this guidance.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" and "internal control over financial reporting" as of the end of the period covered by this Quarterly Report.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that information is accumulated and communicated to management, including the principal executive and financial officer as appropriate, to allow timely decisions regarding required disclosures. Our principal executive officer and principal financial officer evaluated the effectiveness of disclosure controls and procedures as of the end of the period covered by this Quarterly Report ("Evaluation Date"), pursuant to Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the Company identified a material weakness relating to the accounting for complex debt and equity instruments. As such, our principal executive officer and principal financial officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were not operating effectively.

Management believes that the condensed consolidated financial statements in this quarterly report on Form 10-Q fairly present, in all material respects, the Company's financial condition as of the Evaluation Date, and results of its operations and cash flows for the Evaluation Date, in conformity with United States Generally Accepted Accounting Principles ("GAAP").

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that

a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
b) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the Company are being made only in accordance with authorizations of our management and directors; and
c)

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Based on our evaluation under the framework described above, our management concluded that our internal controls over financial reporting were not effective in accordance with Item 308(a)(3) of Regulation S-K as we had "material weaknesses" (as such term is defined below) in our control environment and financial reporting process relating to the accounting for complex debt and equity instruments.

A "material weakness" is defined under SEC rules as a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis by the company's internal controls.

The Company intends to remedy the foregoing material weakness in our control environment and financial reporting process by pursuing third party technical accounting consultation in the matter of transactions that involve complex debt and equity instruments.

A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Based on our evaluation under the framework described above, aside from the material weakness

discussed above, our management concluded that our internal controls over financial reporting were effective in accordance with Item 308(a)(3) of Regulation S-K.

Attestation report of the registered public accounting firm

This Quarterly Report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to the rules of the SEC.

Changes in Internal Control over Financial Reporting

No change in our system of internal control over financial reporting occurred during the period ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II-OTHER INFORMATION

Item 1. Legal Proceedings

No material developments.

Item 1A. Risk Factors.

There have been no material developments to alter the risk factors disclosed in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the period December 31, 2017 through June 30, 2018, we issued 15,522 shares of common stock, with an aggregate value of $48 to Greenridge Global LLC, SP Padda and J Charles Assets in return for investor relations advisory services and construction of leasehold improvements. The shares were issued in reliance upon an exemption pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.3 to the Company's Form 8-K, filed with the SEC on June 15, 2017)
3.2	Amendment to Amended and Restated Certificate of Incorporation (previously filed as Exhibit 3.1 to the Company's Form 8-K, filed with the SEC on January 3, 2018)
3.3	Amended and Restated By-Laws (previously filed as Exhibit 3.1 to the Company's Form 8-K, filed with the SEC on March 29, 2018)
10.1	Agreement for Purchase of Debt, dated February 8, 2018, between CBS Butler Limited and HSBC Invoice Finance (UK) Limited (previously filed as Exhibit 10.1 to the Company's Form 8-K, filed with the SEC on February 13, 2018)
10.2	Agreement for Purchase of Debt, dated February 8, 2018, between The JM Group (IT Recruitment) Limited and HSBC Invoice Finance (UK) Limited (previously filed as Exhibit 10.2 to the Company's Form 8-K, filed with the SEC on February 13, 2018)
10.3	Agreement for Purchase of Debt, dated February 8, 2018, between Longbridge Recruitment 360 Ltd and HSBC Invoice Finance (UK) Limited (previously filed as Exhibit 10.3 to the Company's Form 8-K, filed with the SEC on February 13, 2018)
31.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of Sarbanes Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of Sarbanes Oxley Act of 2002
32.1†	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes Oxley Act of 2002
32.2†	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema
101.CAL	XBRL Taxonomy Calculation Linkbase
101.DEF	XBRL Taxonomy Definition Linkbase
101.LAB	XBRL Taxonomy Label Linkbase
101.PRE	XBRL Taxonomy Presentation Linkbase

† In accordance with SEC Release 33-8238, Exhibits 32.1 and 32.2 are furnished and not filed.

SIGNATURES

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

Date: August 14, 2018 STAFFING 360 SOLUTIONS, INC.

By: /s/ Brendan Flood
Brendan Flood
Chairman and Chief Executive Officer
(Duly Authorized Officer and Principal Executive Officer)

Date: August 14, 2018 STAFFING 360 SOLUTIONS, INC.

By: /s/ David Faiman
David Faiman
Chief Financial Officer
(Duly Authorized Officer, Principal Financial Officer and Principal Accounting Officer)

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