Labor Smart, Inc.
Form 10-Q
November 16, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 25, 2015

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number 000-54654

LABOR SMART, INC.

(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	**45-2433287** (I.R.S. Employer Identification No.)
3270 Florence Road, Suite 200, Powder Springs, GA (Address of principal executive offices)	**30127** (Zip Code)

(770) 222-5888
(Registrant's telephone number, including area code)

Indicate by check mark whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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 definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

Yes No

Number of shares of issuer's common stock outstanding as of November 16, 2015 was 6,627,295,812.

LABOR SMART, INC.

QUARTERLY PERIOD ENDED SEPTEMBER 26, 2015

Index to Report on Form 10-Q

(table of contents)

PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

LABOR SMART, INC.

BALANCE SHEETS

ASSETS		
	September 25, 2015	December 26, 2014
Current assets	(Unaudited)	
Cash and cash equivalents	$127,449	$68,972
Accounts receivable, net	2,530,064	3,068,798
Marketable securities, available for sale	314,797	99,954
Prepaid expense	64,017	322,855
Other assets	253,125	453,341
Total current assets	3,289,452	4,013,920
Deposits	66,000	80,283
Property and equipment, net	76,888	98,790
Customer relationships, net	236,323	385,436
Workers' compensation insurance collateral	785,254	536,771
Total long-term assets	1,164,465	1,101,280
Total assets	$4,453,917	$5,115,200
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued liabilities	$203,196	$190,517
Loan payable to factor	1,743,284	1,638,771
Payroll taxes payable	2,026,803	1,303,337
Notes payable	136,456	—
Notes payable, related party	5,725	14,725
Contingent liability, current portion	113,784	122,129
Convertible notes payable, net of unamortized discount of $244,734 and $1,487,875, respectively	3,514,343	3,894,678
Warrants and bifurcated conversion features	735,675	603,639
Total current liabilities	8,479,266	7,767,796
Contingent liability, long-term portion	—	43,733
Total liabilities	8,479,266	7,811,529

Stockholders' deficit		
Preferred stock, ($.0001 par value, 5,000,000 shares authorized; none issued and outstanding)	—	—
Series A Preferred stock, ($.0001 par value, 51shares authorized; 51 shares issued and outstanding as of September 25, 2015 and December 26, 2014, respectively.	—	—
Common stock; $0.00001 par value; 20,000,000,000 shares authorized, 6,627,295,812 and 180,455,103 issued and outstanding as of September 25, 2015 and December 26, 2014, respectively.	66,274	1,805
Additional paid-in capital	6,743,239	5,550,383
Accumulated deficit	(10,899,740)	(8,313,284)
Accumulated other comprehensive income	64,878	64,767
Total stockholders' deficit	(4,025,349)	(2,696,329)
Total liabilities and stockholders' deficit	$4,453,917	$5,115,200

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

(table of contents)

LABOR SMART, INC.

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	For the three months ended September 25, 2015	For the three months ended September 26, 2014	For the nine months ended September 25, 2015	For the nine months ended September 26, 2014
Revenues, net	$5,749,548	$6,847,744	$16,831,139	$18,078,661
Cost of revenues	4,220,485	5,132,736	12,347,353	13,890,193
Gross profit	1,529,063	1,715,008	4,483,786	4,188,468
Operating expenses				
Payroll expenses	1,000,714	738,563	2,700,200	1,773,150
Bad debt expense	567,987	17,329	749,503	113,375
General and administrative expense	836,767	1,060,543	2,608,492	2,815,645
Total operating expenses	2,405,468	1,816,435	6,058,195	4,702,170
Operating loss	(876,405)	(101,427)	(1,574,409)	(513,702)
Other income (expenses)				
Gain on sale of branch offices	1,015,961	—	1,015,961	—
Interest and finance expense	(347,988)	(1,165,075)	(1,949,262)	(2,913,386)
Gain (loss) on change in fair value in derivative liability	(357,072)	191,192	(82,036)	357,842
Gain (loss) on sale of securities	5,435	(12,018)	3,290	(15,437)
Total other income (expenses)	316,336	(985,901)	(1,012,047)	(2,570,981)
Net loss	$(560,069)	$(1,087,328)	$(2,586,456)	$(3,084,683)
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities	—	78,166	—	73,435
Other comprehensive income (loss)	—	78,166	—	73,435
Comprehensive loss	$(560,069)	$(1,009,162)	$(2,586,456)	$(3,011,248)
Basic and diluted loss per common share	$(0.00)	$(0.04)	$(0.00)	$(0.13)
Basic and diluted weighted average common shares outstanding	5,636,335,289	26,764,068	3,467,777,333	23,711,572

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

(table of contents)

LABOR SMART, INC.

STATEMENT OF CASH FLOWS

(UNAUDITED)

	For the nine months ended September 25, 2015	For the nine months ended September 26, 2014
Cash flows from operating activities:		
Net loss	$(2,586,456)	$(3,084,683)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock-based compensation	(12,222)	119,257
Interest and financing costs	1,540,099	2,389,537
Depreciation and amortization	184,233	114,748
Bad debt expense	749,503	113,375
Loss on sale of securities	(3,290)	15,437
(Gain) loss on change in fair value of derivative liability	82,036	(357,842)
Gain on sale of branch offices	(1,015,961)	—
Changes in operating assets and liabilities:		
Increase (decrease) in accounts receivable	(210,769)	(1,874,151)
Increase (decrease) in prepaid expense and deposits	258,838	(125,104)
Increase (decrease) in other assets	(33,984)	(395,729)
Increase (decrease) in accounts payable and accrued liabilities	12,679	20,197
Increase (decrease) in payroll taxes payable	723,466	162,507
Net cash provided by (used in) operating activities	(311,828)	(2,902,451)
Cash flows from investing activities:		
Assets acquired in asset purchase agreement	—	(120,797)
Proceeds from sale of branch offices	1,025,000	—
Purchase of fixed assets	(22,257)	(75,754)
Proceeds from sale of marketable securities	43,133	57,191
Purchase of marketable securities	(254,575)	(99,339)
Net cash provided by (used in) investing activities	791,301	(238,699)
Cash flows from financing activities:		
Proceeds from convertible notes payable	—	3,844,823
Payment on convertible notes payable	(589,430)	(941,039)
Proceeds from notes payable	175,000	—
Payments of notes payable	(38,544)	—
Payment on notes payable - related party	(9,000)	(27,581)
Net cash received from loan payable to factor	104,513	618,031
Payments on contingent liability	(63,535)	(91,442)

Net cash provided by (used in) financing activities	(420,996)	3,402,792
Net change in cash	58,477	261,642
Cash, beginning of period	68,972	178,539
Cash, end of period	$127,449	$440,181
Supplemental disclosure of cash flow information:		
Interest paid	$409,163	$381,399
Taxes paid	$—	$—
Non-cash investing and financing activities		
Shares issued for convertible notes	$660,044	$822,681
Contingency liability associated with asset purchase	$—	$183,194
Convertible note payable derivative liability	$—	$1,300,883
Warrant derivative liability	$—	$46,560

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

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 1 – NATURE OF OPERATIONS

Nature of Business

Labor Smart, Inc. (the "Company") was incorporated in the State of Nevada on May 31, 2011. Labor Smart, Inc. provides temporary blue-collar staffing services. It supplies general laborers on demand to the light industries, including manufacturing, logistics, and warehousing, skilled trades' people, and general laborers to commercial construction industries.

NOTE 2 – GOING CONCERN

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company requires capital for its contemplated operational and marketing activities. The Company's ability to raise additional capital through the future issuances of common stock is unknown. At September 25, 2015, the Company had an accumulated deficit of $10,899,740 and negative working capital of $5,189,814. Also, the Company had a net loss of $2,586,456 for nine months ended September 25, 2015. Additionally, the operating activities of the Company used $311,828 net cash during the same nine month period. The obtainment of additional financing and increasingly profitable operations are necessary for the Company to continue operations. The ability to successfully resolve these factors raise substantial doubt about the Company's ability to continue as a going concern. These condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These condensed consolidated financial statements are presented in United States dollars and have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP"). On January

20, 2015, the Company incorporated a 100% owned subsidiary, Skill Corp, Inc. On March 2, 2015, the Company incorporated the following 100% owned subsidiaries: LSI Corp, LLC, Labor Smart TN, LLC, Labor Smart SE, LLC, Labor Smart SE II, LLC, Labor Smart NAT, LLC, Labor Smart GA, LLC and Labor Smart MW, LLC which are included in these condensed consolidated financial statements. All significant inter-company accounts and transactions have been eliminated.

The Company has a 52-53 week fiscal year ending on the Friday closest to December 31. This change was effective with the end of the registrant's fiscal second quarter ended June 27, 2014. The change to a 52-53 week fiscal year was retroactively applied as if it was adopted as of January 1, 2014. The registrant's current fiscal year ends on December 25, 2015 and comprises 52 weeks.

Pursuant to the rules and regulations of the Securities and Exchange Commission for Form 10-Q, the condensed consolidated financial statements, footnote disclosures and other information normally included in condensed consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The condensed consolidated financial statements contained in this report are unaudited but, in the opinion of management, reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the condensed consolidated financial statements.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair Value of Financial Instruments

As required by the Fair Value Measurements and Disclosures Topic of the FASB ASC ("ASC 820-10"), fair value is measured based on a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The three levels of the fair value hierarchy are described below:

Level 1	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level 2	Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;
Level 3	Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

Pursuant to ASC 825, the fair value of cash and marketable securities is determined based on "Level 1" inputs, which consist of quoted prices in active markets for identical assets. The Company believes that the recorded values of cash, accounts receivables, marketable securities, accounts payable and accrued liabilities, and notes payable approximate their current fair values because of their nature and respective relatively short maturity dates or durations.

Assets measured at fair value on a recurring basis were presented on the Company's balance sheets as of September 25, 2015 and December 26, 2014 as follows:

	Fair Value Measurements as of September 25, 2015 Using:			
	Total Carrying Value as of	**Quoted Market Prices in Active Markets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
	September 25, 2015	**(Level 1)**	**(Level 2)**	**(Level 3)**
Assets:				

Equity securities	$ 278,889	$ 178,889	$ 0	$ 100,000
Warrant	35,908	0	0	35,908
Total	$314,797	$ 178,889	$ 0	$ 135,098
Liabilities:				
Convertible note payable derivative liability	$ 730,784	$ 0	$ 0	$ 730,784
Warrant derivative liability	4,891	0	0	4,891
Contingent consideration payable	113,784	0	0	113,784
Total	$849,459	$0	$0	$849,459

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

	Fair Value Measurements as of December 26, 2014 Using:			
	Total Carrying Value as of December 26, 2014	**Quoted Market Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Equity securities	$ 52,610	$ 52,610	$ 0	$ 0
Warrant	47,344	0	0	47,344
Total	$99,954	$ 52,610	$ 0	$ 47,344
Liabilities:				
Convertible note payable derivative liability	$ 601,345	$ 0	$ 0	$ 601,345
Warrant derivative liability	2,294	0	0	2,294
Contingent consideration payable	165,862	0	0	165,862
Total	$769,501	$0	$0	$769,501

Changes in convertible note payable derivative liability during the nine months ended September 25, 2015 were as follows:

Opening balance at December 26, 2014	$ 601,345
Fair value of convertible derivative liability	69,686
Loss on derivative liabilities	(19,686)
Loss on change in fair value of derivative liability	79,439
Closing balance at September 25, 2015	$ 730,784

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Changes in warrant derivative liability during the nine months ended September 25, 2015 were as follows:

Opening balance at December 26, 2014	$2,294
Loss on change in fair value of derivative liability	2,597
Closing balance at September 25, 2015	$4,891

Changes in contingent liability during the nine months ended September 25, 2015 were as follows:

Opening balance at December 26, 2014	$165,862
Payments	(63,534)
Interest	11,456
Closing balance at September 25, 2015	$113,784

Equity securities comprise publicly traded shares of common stock. The warrant gives the Company, the right but not the obligation, to purchase 100,000 shares of Science to Consumers, Inc. (formerly Argon Beauty Corp.) (OTCBB:BEUT). The warrant is valued at the end of each accounting period using the Black Scholes option valuation model using the following inputs at September 25, 2015: stock price $0.43, exercise price $0.50, expected life 1.98 years, volatility 202%, dividends 0% and discount rate 1.08%.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of less than 90 days. Cash equivalents are placed with high credit quality financial institutions and are primarily in money market funds. The carrying value of those investments approximates fair value. The Company maintains its cash in bank deposit accounts which may exceed federally insured limits. As of September 25, 2015, the Company’s accounts are insured for $250,000 by FDIC for US bank deposits.

Investments

Available for sale securities are recorded at fair value. Unrealized holding gains and losses on available for sale securities are excluded from earnings and included in other comprehensive income (loss).

On September 18, 2015, the Company purchased 560 B Ordinary Shares, 2.5% interest, of TempBuddy Limited for $100,000 in cash. The investment is recorded as cost, which approximates fair value given the short period the Company has held the investment.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax balances. Deferred tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to the taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. Deferred income taxes are reported for timing differences between items of income or expense reported in the consolidated financial statements and those reported for income tax purposes in accordance with FASB ASC 740-10, "Income Taxes," which requires the use of the asset/liability method of accounting for income taxes.

The Company provides for deferred taxes for the estimated future tax effects attributable to temporary differences and carry-forwards when realization is more likely than not.

Revenue Recognition

The Company recognizes revenues and the related costs when persuasive evidence of an arrangement exists, delivery and acceptance has occurred or service has been rendered, the price is fixed or determinable, and collection of the resulting receivable is reasonably assured. Amounts invoiced or collected in advance of product delivery or providing services are recorded as deferred revenue. The Company accrues for customer credits, bad debts, and other allowances based on its historical experience. Staffing revenue is recognized as the services are performed. Revenue also includes billable travel and other reimbursable costs and is recorded net of sales tax.

Deferred Financing Costs

Deferred financing costs consist of costs incurred to obtain debt financing, including legal fees, origination fees and administration fees. Costs associated with the Convertible Promissory Notes are deferred and amortized in our statements of operations using the straight-line method, which approximates the effective interest method, over the terms of the respective financing instrument.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. These estimates and judgments are based on historical information, information that is currently available to the Company, and on various other assumptions that the Company believes to be reasonable under the circumstances. Actual results could differ from those estimates.

Factoring Agreements and Accounts Receivable

On July 31, 2013 the Company entered into a Purchase and Sale Agreement with Transfac Capital, Inc. (“Transfac”). Advances to the Company from Transfac are with recourse and are secured by assets of the Company and are treated as a secured financing arrangement. As of September 25, 2015 and December 26, 2014, factored accounts receivable total $1,743,284 and $1,638,771, respectively.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Doubtful Accounts

The Company allows for an estimated amount of receivables that may not be collected. The Company estimates its allowance for doubtful accounts based on historical experience and customer relationships. As of September 25, 2015 and December 26, 2014, the Company has recorded an allowance of $388,526 and $110,605, respectively.

Property and Equipment

Property and equipment are stated at the lower of cost or fair value. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, as follows:

Description	Estimated Life
Office equipment and furniture	3 years

The estimated useful lives are based on the nature of the assets as well as current operating strategy and legal considerations such as contractual life. Future events, such as property expansions, property developments, new competition, or new regulations, could result in a change in the manner in which the Company uses certain assets requiring a change in the estimated useful lives of such assets.

	September 25, 2015	December 26, 2014
Office equipment and furniture	$138,309	$131,295
Less: accumulated depreciation	(61,421)	(32,505)
	$76,888	$98,790

Depreciation expense was $11,836 and $7,147 for the three months ended September 25, 2015 and September 26, 2014, respectively and $35,120 and $14,693 for the nine months ended September 25, 2015 and September 26, 2014, respectively.

Customer Relationships

Customer relationships comprise customer lists acquired from Qwik Staffing Solutions, Inc. on April 29, 2013 with an estimated fair value of $294,100, from Shirley's Employment Service, Inc. on April 9, 2014 with an estimated fair value of $162,461 and from Kwik Jobs on September 26, 2014 with an estimated fair value of $141,529. Customer lists are amortized on a straight-line basis over three years.

	September 25, 2015	December 26, 2014
Customer lists	$598,090	$598,090
Less: accumulated amortization	(361,767)	(212,654)
	$236,323	$385,436

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Amortization expense was $49,704 and $36,692 for the three months ended September 25, 2015 and September 26, 2014, respectively and $149,113 and $99,409 for the nine months ended September 25, 2015 and September 26, 2014, respectively.

Earnings (loss) per share

Basic earnings (loss) per common share is computed by dividing net income (loss) available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per common share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if potentially dilutive securities had been issued. Potentially dilutive common shares outstanding stock options assumed to be exercised or vested and paid out of shares of common stock and warrants assumed to be exercised. Outstanding stock options and warrants are disclosed in Note 11 Stockholders' Deficit.

Convertible Notes Payable

i) Beneficial Conversion Feature

If the conversion features of conventional convertible debt provides for a rate of conversion that is below market value, this feature is characterized as a beneficial conversion feature ("BCF"). A BCF is recorded by the Company as a debt discount pursuant to ASC Topic 470-20 "Debt with Conversion and Other Options." In those circumstances, the convertible debt is recorded net of the discount related to the BCF and the Company amortizes the discount to interest expense over the life of the debt using the effective interest method.

ii) Debt Discount

The Company determines if the convertible debenture should be accounted for as liability or equity under ASC 480, Liabilities — Distinguishing Liabilities from Equity. ASC 480, applies to certain contracts involving a company's own equity, and requires that issuers classify the following freestanding financial instruments as liabilities. Mandatorily redeemable financial instruments, obligations that require or may require repurchase of the issuer's equity shares by transferring assets (e.g., written put options and forward purchase contracts), and certain obligations where at inception the monetary value of the obligation is based solely or predominantly on:

– A fixed monetary amount known at inception, for example, a payable settleable with a variable number of the issuer's equity shares with an issuance date fair value equal to a fixed dollar amount,

– Variations in something other than the fair value of the issuer's equity shares, for example, a financial instrument indexed to the S&P 500 and settleable with a variable number of the issuer's equity shares, or

– Variations inversely related to changes in the fair value of the issuer's equity shares, for example, a written put that could be net share settled.

If the entity determined the instrument meets the guidance under ASC 480 the instrument is accounted for as a liability with a respective debt discount. The Company records debt discounts in connection with raising funds through the issuance of convertible debt (see Note 7). These costs are amortized to non-cash interest expense over the life of the debt. If a conversion of the underlying debt occurs, a proportionate share of the unamortized amounts is immediately expensed.

iii) Derivative Financial Instruments

Derivative financial instruments, as defined in ASC 815, “Accounting for Derivative Financial Instruments and Hedging Activities”, consist of financial instruments or other contracts that contain a notional amount and one or more underlying (e.g. interest rate, security price or other variable), require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company does not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, the Company has issued financial instruments including senior convertible promissory notes payable and freestanding stock purchase warrants with features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by ASC 815, in certain instances, these instruments are required to be carried as derivative liabilities, at fair value, in our consolidated financial statements.

Stock-based compensation

The Company records stock based compensation in accordance with the guidance in ASC Topic 505 and 718 which requires the Company to recognize expenses related to the fair value of its employee stock option awards. This eliminates accounting for share-based compensation transactions using the intrinsic value and requires instead that such transactions be accounted for using a fair-value-based method. The Company recognizes the cost of all share-based awards on a graded vesting basis over the vesting period of the award.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with FASB ASC 718-10 and the conclusions reached by the FASB ASC 505-50. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earliest of a performance commitment or completion of performance by the provider of goods or services as defined by FASB ASC 505-50.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (“FASB ASU 2014-09”). This standard update clarifies the principles for recognizing revenue and develops a common revenue standard for U.S. generally accepted accounting principles (GAAP) and International Financial Reporting

Standards. The standard update intends to provide a more robust framework for addressing revenue issues; improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; and provide more useful information to users of consolidated financial statements through improved disclosure requirements. Upon adoption of this standard update, the Company expects that the allocation and timing of revenue recognition will be impacted. The provisions of FASB ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and are to be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. Early application is not permitted. The Company is currently evaluating the impact that this standard update will have on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements - Going Concern. The new standard requires management of public and private companies to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and, if so, disclose that fact. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The standard requires management to evaluate, for each reporting period, whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. The new standard is effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of the ASU to have a significant impact on our consolidated financial statements.

The Company has implemented all new accounting pronouncements that are in effect and that may impact its consolidated financial statements and does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its consolidated financial statements.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 4 – PREPAID EXPENSES

As of September 25, 2015 and December 26, 2014, the Company had prepaid expenses of $64,017 and $322,855, respectively. Prepaid expenses at September 25, 2015 comprised primarily of prepaid lease payments, insurance and services.

NOTE 5 – AGREEMENT FOR PURCHASE AND SALE OF ASSETS

On August 5, 2015, the Company and Christopher Ryan Schadel, the Chief Executive Officer of the Company, ("Schadel") entered into an Agreement for Purchase and Sale of Assets (the "Asset Purchase Agreement") with Harris Ventures, Inc., a Georgia corporation ("Harris Ventures"), effective as of July 31, 2015. Under the terms of the Asset Purchase Agreement, Harris Ventures will purchase the following branch offices of the Company: Augusta, Georgia, Charleston, South Carolina, Columbia, South Carolina, Denver, Colorado, and Greenville, South Carolina (the "Branch Offices"), and all assets associated with the Branch Offices, excluding open accounts receivable. The purchase price for the Branch Offices was $1,025,000 in cash, of which $135,000 was due upon the execution of the Agreement and the remaining $890,000 due on August 12, 2015. The entire purchase price has been received in full. The Company and Schadel also agreed that, for a period of five (5) years (except for the branch offices located in South Carolina, in which the restricted period shall be three (3) years) not to compete within a forty (40) mile radius of the Branch Offices.

NOTE 6 – FACTORING AGREEMENT

On July 31, 2013 the Company entered into a Purchase and Sale Agreement with Transfac Capital, Inc. ("Transfac"). Under the terms of the Purchase and Sale Agreement, Transfac shall have the right, but not the obligation, to purchase up to Two Million Dollars ($2,000,000) worth of accounts receivable (the "Maximum Advances") of the Company. For each account receivable purchased, Transfac shall advance ninety percent (90%) of the face value of the account and the balance after receipt of full payment on the account. As consideration, the Company shall pay Transfac two percent (2%) of the average monthly balance of the outstanding accounts purchased, with a minimum of one half of one percent (0.5%) of the Maximum Advances per month, as long as the Purchase and Sale Agreement remains in effect.

The factoring line of credit with Transfac has been treated as a secured financing arrangement. As of September 25, 2015 and December 26, 2014 under the agreement with Transfac, the Company had factored receivables in the amounts of $1,743,284 and $1,699,900, recorded reserve deposits of $275,640 and $448,968 included in other current assets, and recorded a liability of $1,467,644 and $1,638,771, respectively. Discounts and interest provided during factoring of the accounts receivable have been expensed on the statements of operations as interest expense. Interest expense related to the factoring arrangement was $120,105 and $94,333 for the three months ended September 25, 2015 and September 26, 2014, respectively and $398,405 and $218,916 for the nine months ended September 25, 2015 and September 26, 2014, respectively.

NOTE 7 – RELATED PARTY

On April 25, 2013, the Company entered into a loan agreement with the CEO of the Company in the amount of $175,768. This loan is payable on demand, unsecured, and bears 0% interest per annum. This loan consolidates all previous loans issued. As of September 25, 2015, $170,043 of this note has been repaid and $5,725 (December 26, 2014 - $14,725) of this note remains outstanding.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 8 – LOAN PAYABLE

On July 17, 2015, the Company issued a loan payable for $175,000 in cash. The loan payable matures on April 18, 2016 and is due in daily installments of $1,148, including principal and interest at 59%.

NOTE 9 – CONVERTIBLE PROMISSORY NOTES

Unless otherwise stated in Note 8, these convertible promissory notes have been accounted for in accordance with ASC 480 *Distinguishing Liabilities from Equity*.

On March 4, 2013, the Company issued a Convertible Promissory Note (“Note”) to Vista Capital Investments, LLC (“Holder”), in the original principal amount of $275,000 bearing a 12% annual interest rate and maturing one year for $250,000 of consideration paid in cash and a $25,000 original issue discount. The Company may repay the Note any time and if repaid within 90 days of date of issue with an interest rate is 0%. This Note together with any unpaid accrued interest is convertible into shares of common stock at the Holder’s option at a variable conversion price calculated as lessor of (a) $0.62 or (b) 60% of the lowest trade occurring during the 25 consecutive trading days immediately preceding the conversion date.

i) On January 14, 2014, the Company received cash proceeds of $25,000 on the third tranche of the Note. During the year ended December 26, 2014, the Holder converted 1,431,373 shares of common stock of the Company with a fair value of $51,654 to settle $20,540 of principal and interest.

ii) On March 19, 2014, the Company received cash proceeds of $25,000 on the fourth tranche of the Note. During the year ended December 26, 2014, the Holder converted 3,800,000 shares of common stock of the Company with a fair value of $33,410 to settle $17,364 in principal and interest, respectively. During the nine months ended September 25, 2015, the Holder converted 15,000,000 shares of common stock of the Company with a fair value of $15,000 to settle $8,100 of principal and interest.

iii) On May 27, 2014, the Company received cash proceeds of $25,000 on the fifth tranche of the Note.

iv) On July 24, 2014, the Company received cash proceeds of $25,000 on the sixth tranche of the Note.

On June 15, 2015, the third, fourth, fifth and sixth tranche were settled and paid in full for $75,000 in cash.

On December 12, 2013 the Company entered into a Convertible Promissory Note (“Note”) with Tonaquint Inc. (“Holder”) in the original principal amount of $115,000 bearing a 10% annual interest rate and maturing November 12, 2014. The Note is due is six equal monthly installments plus interest (“Installment Amount”) commencing nine months after the issue date. At the option of the Holder, the Installment Amount is convertible into shares of common stock of the Company at a variable conversion price calculated at 60% of the market price which means the average of the lowest two trading prices during the twenty trading day period ending on the latest complete trading day prior to the conversion date. The Company may elect to prepay in cash all or any portion of the outstanding balance of the Note if the Company pays the holder 125% of the outstanding balance. The Company received cash proceeds of $100,000, which was net of original issue discount of $83,703. During the year ended December 26, 2014, the Company elected to pay $32,457 in cash and the Holder converted 713,167 shares of common stock of the Company with a fair market value of $138,205 to settle $77,528 in principal and interest. During the nine months ended September 25, 2015, the Holder converted 43,713,145 shares of common stock of the Company with a fair value of $48,084 to settle $24,042 of principal and interest. At January 16, 2015, the Note was paid in full.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On January 31, 2014, the Company entered into a Convertible Promissory Note ("Note") with Tonaquint Inc. ("Holder") in the original principal amount of $115,000 less an original issuer's discount of $10,000 and transaction costs of $5,000 bearing a 0% annual interest rate and maturing December 31, 2014. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. The Note is due in six equal monthly installments plus interest ("Installment Amount") commencing nine months after the issue date. At the option of the Holder, the Installment Amount is convertible into shares of common stock of the Company at a variable conversion price calculated at 60% of the market price which means the average of the lowest two trading prices during the twenty trading day period ending on the latest complete trading day prior to the conversion date. The Company may elect to prepay in cash all or any portion of the outstanding balance of the Note if the Company pays the holder 125% of the outstanding balance. In October 2014, the Company paid principal and interest of $88,577 in cash. At September 25, 2015, the Note is recorded at a fully accreted value of $3,969 less unamortized debt discount of $0.

On March 27, 2014, the Company entered into a 10% Original Issue Discount Convertible Promissory Note ("Note") with Gemini Master Fund, Ltd. ("Holder") in the original principal amount of $220,000 bearing a 10% annual interest rate and maturing January 1, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. At the option of the Holder:

i) The Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at a variable conversion price calculated at 65% of the market price which means the average of the lowest volume weighted average price during the twenty trading day period ending prior to the conversion date, or

ii) All principal, costs, charges and interest amounts outstanding may be exchanged for shares of the Company's common stock at the Conversion Price of $0.25 per share. The Conversion Price is subject to an anti-dilution adjustment.

The Company may repay the Note at 130% of the original principal amount plus interest. During the year ended December 26, 2014, the Holder converted 2,386,034 shares of common stock of the Company with a fair value of $143,162 to settle $30,000 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 24,923,077 shares of common stock of the Company with a fair value of $29,908 to settle $16,200 of principal and interest. During the nine months ended September 25, 2015, the Company paid $9,600 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $277,815 less unamortized debt discount of $0.

On April 2, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Coventry Enterprises, LLC (“Holder”) in the original principal amount of $101,000 less transaction costs of $13,000 bearing a 10% annual interest rate and maturing April 5, 2015. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 58% of the lowest bid price during the twelve trading days prior to the conversion date including the day upon which a Notice of Conversion is received by the Company. The Company may repay the Note if repaid within 180 days of date of issue at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the year ended December 26, 2014, the Holder converted 27,737,439 shares of common stock of the Company with a fair value of $306,184 to settle $98,856 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 8,015,809 shares of common stock of the Company with a fair value of $12,825 to settle $5,050 of principal and interest. On January 21, 2015, the note was paid in full.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On April 14, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Group 10 Holdings, LLC (“Holder”) in the original principal amount of $113,000 less original issue discount of $12,000 bearing a 12% annual interest rate and maturing April 17, 2015. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 55% of the lowest trading price of any day during the 20 consecutive trading days prior to the date on which the Holder elects to convert all or part of the Note. The Company may repay the Note if repaid within 30 days of date of issue at 125% of the original principal amount plus interest and between 31 days and 179 days at 135% of the original principal amount plus interest and thereafter, the Company may repay the Note at 145% of the original principal amount plus interest. During the year ended December 26, 2014, the Holder converted 26,340,100 shares of common stock of the Company with a fair value of $170,445 to settle $71,944 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 110,890,000 shares of common stock of the Company with a fair value of $120,344 to settle $60,979 of principal and interest. On January 21, 2015, the note was paid in full.

On April 16, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Tonaquint Inc. (“Holder”) in the original principal amount of $115,000 less an original issuer’s discount of $10,000 and transaction costs of $13,000 bearing a 10% annual interest rate and maturing March 16, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. The Note is due in six equal monthly installments plus interest (“Installment Amount”) commencing nine months after the issue date. At the option of the Holder, the Installment Amount is convertible into shares of common stock of the Company at a variable conversion price calculated at 60% of the market price which means the average of the lowest two trading prices during the twenty trading day period ending on the latest complete trading day prior to the conversion date. The Company may elect to prepay in cash all or any portion of the outstanding balance of the Note if the Company pays the holder 125% of the outstanding balance. During the year ended December 26, 2014, the Holder converted 18,429,925 shares of common stock of the Company with a fair value of $94,398 to settle $69,530 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 261,500,000 shares of common stock of the Company with a fair value of $47,150 to settle $28,628 of principal and interest. During the nine months ended September 25, 2015, the Company paid $30,000 in cash for principal and interest. On June 15, 2015, the note was paid in full.

On April 21, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Tailwind Partners 3, LLC (“Holder”) in the original principal amount of $106,000 less transaction costs of $5,000 bearing a 12% annual interest rate and maturing January 21, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 120 days of date of issue at 125% of the original principal amount plus interest, between 121 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the year ended December 26, 2014, the Holder converted 8,620,690 shares of common stock of the Company with a fair value of $142,698 to settle $49,000 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 612,093,526 shares of common stock of the Company with a fair value of $116,540 to settle $58,200 of principal and interest. During the nine months ended September 25, 2015, the Company paid $7,500 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $35,592 less unamortized debt discount of $0.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On May 14, 2014, the Company entered into a Convertible Promissory Note ("Note") with KBM Worldwide, Inc. ("Holder") in the original principal amount of $103,500 less transaction costs $3,500 bearing an 8% annual interest rate and maturing February 16, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 60 days of date of issue at 119% of the original principal amount plus interest, between 61 days and 90 days at 125% of the original principal amount plus interest, between 91 days and 120 days at 130% of the original principal amount plus interest and 121 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the year ended December 26, 2014, the Holder converted 33,354,930 shares of common stock of the Company with a fair value of $98,434 to settle $60,345 of principal and interest. From January 1, 2015 to January 12, 2015, the Holder converted 69,688,011 shares of common stock of the Company with a fair value of $86,735 to settle $46,595 of principal and interest. On January 12, 2015, the note was paid in full.

On May 27, 2014, the Company issued a Convertible Promissory Note ("Note") to JMJ Financial ("Holder"), in the original principal amount of $330,000 bearing a 12% annual interest rate and maturing in one year for $300,000 of consideration paid in cash and a $30,000 original issue discount. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. The Company may repay the Note any time and if repaid within 90 days of date of issue with an interest rate is 0%. This Note together with any unpaid accrued interest is convertible into shares of common stock at the Holder's option at a variable conversion price calculated as lessor of (a) $0.30 or (b) 60% of the lowest trade occurring during the 25 consecutive trading days immediately preceding the conversion date. On May 27, 2014, the Company received cash of $100,000 in the first tranche, which was net of original issue discount of $10,000. On August 19, 2014, the Company received cash of $50,000 in the second tranche, which was net of original issue discount of $5,000 bearing a 8% annual interest and maturing in one year. During the year ended December 26, 2014, the Holder converted 8,600,000 shares of common stock of the Company with a fair value of $25,880 to settle $14,256 of principal and interest. During the nine months ended September 25, 2015, the Holder converted 842,340,000 shares of common stock of the Company with a fair value of $129,439 to settle $70,598 of principal and interest. At September 25, 2015, the first tranche of the Note is recorded at a fully accreted value of $51,512 less unamortized debt discount of $0. At September 25, 2015, the second tranche of the Note is recorded at a fully accreted value of $91,479 less unamortized debt discount of $0.

On June 6, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Firehole River Capital, LLC (“Holder”) in the original principal amount of $106,000 less transaction costs of $5,000 bearing a 12% annual interest rate and maturing March 6, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 120 days of date of issue at 125% of the original principal amount plus interest, between 121 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the nine months ended September 25, 2015, the Holder converted 145,805,413 shares of common stock of the Company with a fair value of $72,617 to settle $33,000 of principal and interest. During the nine months ended September 25, 2015, the Company paid $25,000 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $106,900 less unamortized debt discount of $0.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On June 9, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Group 10 Holdings, LLC (“Holder”) in the original principal amount of $113,000 less an original issue discount of $12,000 bearing a 12% annual interest rate and maturing June 9, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 55% of the lowest trading price of any day during the 20 consecutive trading days prior to the date on which the Holder elects to convert all or part of the Note. The Company may repay the Note if repaid within 30 days of date of issue at 125% of the original principal amount plus interest and between 31 days and 179 days at 135% of the original principal amount plus interest and thereafter, the Company may repay the Note at 145% of the original principal amount plus interest. During the nine months ended September 25, 2015, the Holder converted 611,130,000 shares of common stock of the Company with a fair value of $65,343 to settle $33,612 of principal and interest. During the nine months ended September 25, 2015, the Company paid $14,005 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $142,946 less unamortized debt discount of $0.

On July 3, 2014, the Company received cash proceed of a Convertible Promissory Note (“Note”) dated June 26, 2014 with JSJ Investment Inc. (“Holder”) in the original principal amount of $101,000 bearing a 10% annual interest rate and maturing December 27, 2014. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. Upon the maturity date, this note has a cash redemption value of 135%. This provision only may be exercise if the consent of the Note holder is obtained. During the nine months ended September 25, 2015, the Holder converted 215,886,723 shares of common stock of the Company with a fair value of $75,293 to settle $38,340 of principal and interest. During the nine months ended September 25, 2015, the Company paid $71,214 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $8,444 less unamortized debt discount of $0.

On July 8, 2014, the Company entered into a Convertible Promissory Note (“Note”) with Tailwind Partners, LLC (“Holder”) in the original principal amount of $106,000 less transaction costs of $5,000 bearing a 12% annual interest rate and maturing April 8, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder’s option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 120 days of date of issue at 125% of the original principal amount plus interest, between 121 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the nine months ended September 25, 2015, the Company paid $64,000 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $106,135 less unamortized debt discount of $0.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On July 11, 2014, the Company entered into a Convertible Promissory Note ("Note") with Tonaquint Inc. ("Holder") in the original principal amount of $225,000 less an original issuer's discount of $20,000 and transaction costs of $16,000 bearing a 10% annual interest rate and maturing June 11, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. The Note is due in six equal monthly installments plus interest ("Installment Amount") commencing nine months after the issue date. At the option of the Holder, the Installment Amount is convertible into shares of common stock of the Company at a variable conversion price calculated at 60% of the market price which means the average of the lowest two trading prices during the twenty trading day period ending on the latest complete trading day prior to the conversion date. The Company may elect to prepay in cash all or any portion of the outstanding balance of the Note if the Company pays the holder 125% of the outstanding balance. During the nine months ended September 25, 2015, the Holder converted 872,000,000 shares of common stock of the Company with a fair value of $94,700 for $52,075 of principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $272,754 less unamortized debt discount of $0.

On July 11, 2014, the Company entered into a Convertible Promissory Note ("Note") with Macallan Partners, LLC ("Holder") in the original principal amount of $115,000 less an original issue discount of $14,000 and transaction costs of $8,080 bearing a 0% annual interest rate and maturing January 7, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the lowest trading price of any day during the 15 consecutive trading days prior to the date on which the Holder elects to convert all or part of the Note. The Company may repay the Note if repaid within 60 days of date of issue at 125% of the original principal amount plus interest, and between 61 days and 120 days at 130% of the original principal amount plus interest and between 121 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the nine months ended September 25, 2015, the Holder converted 376,666,667 shares of common stock of the Company with a fair value of $68,126 to settle $33,000 of principal and interest. During the nine months ended September 25, 2015, the Company paid $17,500 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $111,207 less unamortized debt discount of $0.

On July 15, 2014, the Company issued a Convertible Promissory Note ("Note") to Iconic Holding, LLC ("Holder"), in the original principal amount of $110,250 less an original issue discount of $5,250 and transaction costs of $8,340 bearing a 0% annual interest rate and maturing July 15, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This unsecured Note is convertible into shares of common stock at the Holder’s option at a variable conversion price calculated at 60% of the lowest trading price of any day during the 10 consecutive trading days prior to the dated on which the Holder elects to convert all or part of the Note. The Company may repay the Note within 60 days of date of issue at 125% of the original principal amount plus interest, between 60 days and 120 days at 130% of the original principal amount plus interest plus 30,000 shares of common stock of the Company and between 120 days and 180 days at 135% of the original principal amount plus interest plus 60,000 shares of common stock of the Company. Thereafter, the Note may only be repaid with the consent of the Holder. During the nine months ended September 25, 2015, the Holder converted 263,993,047 shares of common stock of the Company with a fair value of $62,521 to settle $31,673 of principal and interest. During the nine months ended September 25, 2015, the Company paid $20,000 in cash for principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $97,628 less unamortized debt discount of $0.

(table of contents)

LABOR SMART, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 25, 2015

(Unaudited)

NOTE 9 – CONVERTIBLE PROMISSORY NOTES (CONTINUED)

On July 22, 2014, the Company entered into a Convertible Promissory Note ("Note") with Firehole River Capital, LLC ("Holder") in the original principal amount of $106,000 less transaction costs of $8,080 bearing a 12% annual interest rate and maturing April 22, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the ten trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 120 days of date of issue at 125% of the original principal amount plus interest, between 121 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. During the nine months ended September 25, 2015, the Company paid $64,000 in cash for principal and interest. Thereafter, the Company does not have the right of prepayment. At September 25, 2015, the Note is recorded at a fully accreted value of $105,891 less unamortized debt discount of $0.

On July 23, 2014, the Company entered into a Convertible Promissory Note ("Note") with WHC Capital, LLC ("Holder") in the original principal amount of $101,000 less transaction costs of $5,000 bearing a 12% annual interest rate and maturing July 23, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the market price which means the average of the lowest three trading prices during the fifteen trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 120 days of date of issue at 125% of the original principal amount plus interest, between 121 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the nine months ended September 25, 2015, the Holder converted 325,888,610 shares of common stock of the Company with a fair value of $46,723 to settle $27,089 of principal and interest. At September 25, 2015, the Note is recorded at a fully accreted value of $146,726 less unamortized debt discount of $0.

On August 6, 2014, the Company entered into a Convertible Promissory Note ("Note") with LG Capital Funding, LLC ("Holder") in the original principal amount of $106,000 less transaction costs of $5,000 bearing a 10% annual interest rate and maturing August 6, 2015. At September 25, 2015, the Note has passed its maturity date and the Company has not received a notice of default. This Note together with any unpaid accrued interest is convertible into shares of common stock of the Company at the Holder's option at a variable conversion price calculated at 58% of the market price which means the lowest bid price during the twelve trading day period ending on the latest complete trading day prior to the conversion date. The Company may repay the Note if repaid within 90 days of date of issue at 125% of the original principal amount plus interest, between 91 days and 150 days at 130% of the original principal amount plus interest and between 151 days and 180 days at 135% of the original principal amount plus interest. Thereafter, the Company does not have the right of prepayment. During the nine months ended September 25,