ALJ REGIONAL HOLDINGS, INC.

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

The following discussion and analysis of our financial condition and results of operations should be read together with (i) the consolidated audited financial statements and the related notes of ALJ Regional Holdings, Inc., (ii) the audited financial statements of Phoenix Color Corp., and the unaudited pro forma condensed combined financial statements, included elsewhere in this Form 10. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed in "Risk Factors" and in other parts of this Form 10.

Overview

ALJ Regional Holdings, Inc. ("ALJ," or "we") is a holding company that operates Faneuil, Inc., or Faneuil, Floors-N-More, LLC, dba Carpets N' More, or Carpets, and Phoenix Color Corp., or Phoenix. With several members of senior management and our Board of Directors coming from long careers in the professional service industry, ALJ is focused on acquiring and operating exceptional customer service-based businesses.

We achieved higher net revenue for both the three months ended December 31, 2015 and for the year ended September 30, 2015, compared to the same period in 2014, primarily due to our acquisition of Phoenix in August of 2015 and increases in net revenue at Carpets, partially offset by a decrease in net revenue at Faneuil.

We continue to see our business evolve as we execute on our strategy of buying undervalued companies, such as our acquisition of Phoenix during the year ended September 30, 2015. In analyzing the financial impact of any potential acquisition, we focus on earnings, operating margin, cash flow and return on invested capital targets. We hire successful and experienced management teams to run each of our operating companies and incentivize them to drive higher profits. We are focused on increasing our revenues at each of our operating subsidiaries by investing in sales and marketing and expanding into new products and markets. During the year ended September 30, 2015, we invested additional resources at Faneuil to focus on state and local government business and expanded our Cabinet division at Carpets to focus on higher-margin cabinet products. Additionally, we invest in our company's infrastructure to maintain and improve a long-term competitive cost structure.

During the quarter ended December 31, 2015, we also invested in uplisting our stock to the NASDAQ market. We believe that our investment will provide greater liquidity for our investor base and allow us to better leverage our stock in the future.

Results of Operations

Effective October 18, 2013, ALJ acquired substantially all of the capital stock of Faneuil. Effective April 1, 2014, ALJ acquired all of the limited liability company interests of Carpets. Effective August 9, 2015, ALJ acquired all of the capital stock of Phoenix. ALJ included the results of operations in its consolidated financial statements for Faneuil since October 19, 2013, for Carpets since April 1, 2014, and for Phoenix since August 9, 2015.

Three Months Ended December 31, 2015 Compared to Three Months Ended December 31, 2014

The following table sets forth certain consolidated condensed statements of income data as a percentage of net revenue for each period as follows:

	Three Months Ended December 31, 2015		Three Months Ended December 31, 2014	
	Dollars	% of Net Revenue	Dollars	% of Net Revenue
Net revenue [1]				
Faneuil	$ 33,803,349	52.2%	$ 40,738,375	81.7%
Carpets	11,716,061	18.0	9,126,246	18.3
Phoenix	19,277,638	29.8	–	–
Consolidated	**64,797,048**	**100.0**	**49,864,621**	**100.0**
Cost of revenue [2]				
Faneuil	26,571,199	78.6	31,506,104	77.3
Carpets	9,827,433	83.9	7,769,059	85.1
Phoenix (includes depreciation expense of $920,200)	13,364,236	69.3	–	–
Consolidated	**49,762,868**	**76.8**	**39,275,163**	**78.8**
Selling, general and administrative expense[2]				
Faneuil	4,471,448	13.2	3,878,321	9.5
Carpets	1,982,702	16.9	1,479,207	16.2
Phoenix	2,638,364	13.7	–	–
ALJ	1,162,840	–	361,199	–
Consolidated	**10,255,354**	**15.8**	**5,718,727**	**11.5**
Depreciation and amortization[2]				
Faneuil	1,456,221	4.3	1,239,546	3.0
Carpets	143,181	1.2	190,744	2.1
Phoenix	610,573	3.2	–	–
Consolidated	**2,209,975**	**3.4**	**1,430,290**	**2.9**
Segment operating income (loss) [2]				
Faneuil	1,304,481	3.9	4,114,404	10.1
Carpets	(237,255)	(2.0)	(312,764)	(3.4)
Phoenix	2,664,465	13.8	–	–
ALJ	(1,162,840)	–	(361,199)	–
Consolidated	**2,568,851**	**4.0**	**3,440,441**	**6.9**
Total other income (expense), net [3]	(2,181,463)	(3.4)	(229,123)	(0.5)
Provision for income tax (expense) [3]	(63,314)	(0.1)	(224,263)	(0.4)
Net income attributable to non-controlling interest[3]	–	–	(103,859)	(0.2)
Net income attributable to ALJ[3]	**$ 324,074**	**0.5**	**$ 2,883,196**	**5.8**
Basic earnings per share of common stock	**$ 0.01**		**$ 0.09**	
Diluted earnings per share of common stock	**$ 0.01**		**$ 0.08**	

[1]Percentage is calculated as segment net revenue divided by consolidated net revenue.
[2]Percentage is calculated as a percentage of the respective segment net revenue.
[3]Percentage is calculated as a percentage of consolidated net revenue.

Concentrations

Faneuil

For the three months ended December 31, 2015, Faneuil had three customers that accounted for approximately 36.6%, 15.7%, and 11.8% of Faneuil net revenue. For the three months ended December 31, 2014, Faneuil had two customers that accounted for approximately 31.6% and 17.5% of Faneuil net revenue. Although Faneuil's two customers during the three months ended December 31, 2014 were also customers during the three months ended December 31, 2015, the identities of Faneuil's largest customers and their respective contributions to net revenue have varied in the past and will likely continue to vary from period to period. For example, two of Faneuil's contracts with its largest customer were not renewed in 2016 and Faneuil expects to terminate its services under such contracts in late 2016. While Faneuil is appealing the decision not to renew the contracts, we cannot be certain of the success of such appeal, if at all.

Carpets

For the three months ended December 31, 2015, Carpets had two customers that accounted for approximately 33.4% and 22.0% of Carpets net revenue. For the three months ended December 31, 2014, Carpets had two customers that accounted for approximately 29.3% and 21.5% of Carpets net revenue. Although Carpets' two customers during the three months ended December 31, 2014 were also customers during the three months ended December 31, 2015, the identities of Carpets' largest customers and their respective contributions to net revenue have varied in the past and will likely continue to vary from period to period.

For the three months ended December 31, 2015, Carpets had four vendors that accounted for 17.9%, 13.0%, 12.6% and 11.9% of its inventory purchases. For the three months ended December 31, 2014, Carpets had four vendors that accounted for approximately 22.5%, 18.4%, 11.9%, and 10.0% of its inventory purchases.

Phoenix

For the three months ended December 31, 2015, Phoenix had two customers that accounted for approximately 24% and 10.7% of Phoenix's net revenue.

For the three months ended December 31, 2015, Phoenix had two vendors that accounted for approximately 29.9% and 15.8% of its inventory purchases. Phoenix maintains accounts with other vendors to ensure there are no business interruptions resulting from an inability to source material from existing vendors.

Net Revenue

Faneuil Net Revenue

Faneuil net revenue for the three months ended December 31, 2015, was $33.8 million, a decrease of $6.9 million, or 17%, compared to $40.7 million for the three months ended December 31, 2014. The decrease was attributable to the conclusion of several contracts in 2015, which reduced net revenue by approximately $5.1 million, and fewer contract implementations, which reduced net revenue by approximately $1.8 million. The conclusion of contracts was driven by a combination of reduced customer funding and internalization of contract functions by customers. Reduced implementation revenue was also driven by the internalization of contract functions by Faneuil's smaller customers.

Carpets Net Revenue

Carpets net revenue for the three months ended December 31, 2015 was $11.7 million, an increase of $2.6 million, or 28.6%, compared to $9.1 million for the three months ended December 31, 2014. Carpets has several large home builders as customers, who buy product for the construction of new housing developments. Carpets net revenue can fluctuate period over period due to the timing of these large construction projects.

Phoenix Net Revenue

Phoenix net revenue for the three months ended December 31, 2015 was $19.3 million.

Cost of Revenue

Faneuil Cost of Revenue

Faneuil cost of revenue for the three months ended December 31, 2015 was $26.6 million, a decrease of $4.9 million, or 15.7%, compared to $31.5 million for the three months ended December 31, 2014. The decrease in cost of revenue was primarily attributable to the completion of multiple contracts during the three months ended December 31, 2015, which reduced expenses by approximately $3.9 million. Faneuil also realized workforce efficiencies primarily in the manual toll operations, which reduced cost of revenue by approximately $0.7 million. Cost of revenue as a percentage of net revenue was relatively unchanged at 78.6% and 77.3% for the three months ended December 31, 2015 and 2014, respectively.

Carpets Cost of Revenue

Carpets cost of revenue for the three months ended December 31, 2015 was $9.8 million, an increase of $2.1 million, or 26.5%, compared to $7.8 million for three months ended December 31, 2014. The absolute dollar increase was a result of the net revenue increase. Cost of revenue as a percentage of net revenue was 83.9% for the three months ended December 31, 2015 compared to 85.1% for the three months ended December 31, 2014. Cost of revenue as a percentage of net revenue was positively impacted by the mix of higher margin cabinet products sold during the three months ended December 31, 2015 compared to the three months ended December 31, 2014.

Phoenix Cost of Revenue

Phoenix cost of revenue for the three months ended December 31, 2015 was $13.4 million.

Selling, General and Administrative Expense

Faneuil Selling, General and Administrative Expense

Faneuil selling, general and administrative expense for the three months ended December 31, 2015 was $4.5 million an increase of $0.6 million, or 15.3% compared to $3.9 million for the three months ended December 31, 2014. Selling, general and administrative expense as a percentage of Faneuil net revenue was 13.2% for the three months ended December 31, 2015 compared to 9.5% for the three months ended December 31, 2014. The increase in both absolute dollars and as a percentage of net revenue, was primarily attributable to $0.9 million increase in rents and technology-related expenses, primarily within one of our healthcare contracts, partially offset by $0.3 million decrease in expenses from customer contracts that concluded.

Carpets Selling, General and Administrative Expense

Carpets selling, general and administrative expense for the three months ended December 31, 2015 was $2.0 million, an increase of $0.5 million, or 34.0%, compared to $1.5 million for the three months ended December 31, 2014. Selling, general and administrative expense as a percentage of Carpets net revenue was 16.9% for the three months ended December 31, 2015 compared to 16.2% for the three months ended December 31, 2014. The increase was primarily attributable to increased headcount and related payroll expenses of $0.4 million, to support Carpets' expanding customer base and cabinet division.

Phoenix Selling, General and Administrative Expense

Phoenix selling, general and administrative expense for the three months ended December 31, 2015 was $2.6 million, or 13.7% of Phoenix net revenue.

ALJ Selling, General and Administrative Expense

ALJ selling, general and administrative expense for the three months ended December 31, 2015 was $1.2 million, an increase of $0.8 million, or 221.9% compared to $0.4 million for the three months ended December 31, 2014. The increase was primarily attributable to $0.6 million related to accounting fees associated with the Company's first consolidated audit for the fiscal years ended September 30, 2015 and 2014 and related fees associated with the filing of our Form 10 in our initiative for ALJ common stock to be listed on the NASDAQ.

Depreciation and Amortization – Selling, General and Administrative

Faneuil Depreciation and Amortization

Faneuil depreciation and amortization expense for the three months ended December 31, 2015 was $1.5 million, an increase of $0.3 million, or 17.5% compared to $1.2 million for the three months ended December 31, 2014. Depreciation and amortization expense as a percentage of Faneuil net revenue was 4.3% for the three months ended December 31, 2015 compared to 3.0% for the three months ended December 31, 2014. The increase was attributable to new software licenses purchased to support Faneuil's expanding business.

Carpets Depreciation and Amortization

Carpets depreciation and amortization expense for the three months ended December 31, 2015 was $0.14 million, a decrease of $0.05 million, or 24.9% compared to $0.19 million for the three months ended December 31, 2014. Depreciation and amortization expense as a percentage of Carpets net revenue was 1.2% for the three months ended December 31, 2015 compared to 2.1% for the three months ended December 31, 2014. The slight decrease was attributable to fully depreciated capital equipment and an intangible asset that was sold. We expect Carpets depreciation expense to increase as we purchase equipment to automate the granite division.

Phoenix Depreciation and Amortization

Phoenix depreciation and amortization expense for the three months ended December 31, 2015 was $0.6 million, or 3.2% of Phoenix net revenue.

Interest Expense

Consolidated interest expense for the three months ended December 31, 2015 was $2.2 million, an increase of $2.0 million compared to $0.2 million for the three months ended December 31, 2014. Effective August 14, 2015, we entered into a financing agreement with Cerberus Business Finance, LLC (“Cerberus”), to borrow $105.0 million in a term loan (“Cerberus Term Loan”) and have available up to $30.0 million in a revolver (“Cerberus/PNC Revolver” and collectively “Cerberus Debt”). The proceeds from the Cerberus Term Loan were used to finance the purchase of Phoenix, and to refinance existing debt. The Cerberus/PNC Revolver is

used to fund the working capital requirements of our operating segments. During the three months ended December 31, 2015, the Cerberus Debt accrued interest at an annual rate of 7.5% for a total interest expense of $1.9 million. Additionally, we recorded $150,890 of interest expense during the three months ended December 31, 2015 attributable to the amortization of the Cerberus Debt issuance costs.

Provision for Income Taxes

ALJ tax expense for the three months ended December 31, 2015 was $63,314, a decrease of $160,949 or 71.8% compared to $224,263 for the three months ended December 31, 2014. The slight decrease was attributable to lower taxable income.

Net Income Attributable to Non-Controlling Interest

There was no net income attributable to non-controlling interest during the three months ended December 31, 2015 because ALJ exchanged 1,800,000 shares of ALJ common stock for the entire outstanding non-controlling interest in Faneuil and Carpets on July 10, 2015.

Year Ended September 30, 2015 Compared to Year Ended September 30, 2014

	2015	Percentage of Revenue	2014	Percentage of Revenue
Net revenue	$ 209,946,579		$ 149,604,762	
Costs and expenses:				
Cost of revenue	164,756,545	78.5%	115,919,903	77.5%
Selling, general, and administrative expense	28,557,455	13.6%	16,559,476	11.1%
Depreciation and amortization – cost of revenue	518,241	0.2%	-	0.0%
Depreciation and amortization – general and admin	6,651,586	3.2%	4,499,805	3.0%
Loss on sale of assets	448,258	0.2%	-	0.0%
Total costs and expenses	200,932,085	95.7%	136,979,184	91.6%
Income from operations	9,014,494	4.3%	12,625,578	8.4%
Interest expense	(2,187,861)	(1.0%)	(1,269,806)	(0.8%)
Dividend and interest income	9,959	0.0%	32,688	0.0%
Income before taxes	6,836,592	3.3%	11,388,460	7.6%
Income taxes				
Income taxes – current (expense)	(800,135)	(0.4%)	(677,131)	(0.5%)
Income taxes – deferred benefit	6,256,670	3.0%	5,220,423	3.5%
Income tax benefit – total	5,456,535	2.6%	4,543,292	3.0%
Net income	12,293,127	5.9%	15,931,752	10.6%
Net income attributable to non-controlling interest	(400,575)	(0.2%)	(281,966)	(0.2%)
Net income attributable to ALJ	$ 11,892,552	5.7%	$ 15,649,786	10.5%
Net income per common share				
Basic	$ 0.36		$ 0.52	
Diluted	$ 0.35		$ 0.47	
Shares used in per share calculation				
Basic	33,101,793		30,302,436	
Diluted	34,153,536		33,093,008	

Concentrations

Faneuil

For the year ended September 30, 2015, Faneuil had three customers associated with five contracts that accounted for approximately 34.2%, 12.6%, and 11.4% of net revenue, of which approximately $5.8 million, $1.9 million, and $0, respectively, were included in accounts receivable at September 30, 2015. For the year ended September 30, 2014, Faneuil had one customer that accounted for approximately 37.4% of net sales, of which approximately $6.7 million was included in accounts receivable at September 30, 2014.

For the year ended September 30, 2015, Faneuil had eight contracts in which each contract independently contributed to more than 5% of total revenue. In the aggregate, these contracts accounted for $119.9 million, or 80.1% of total revenue. Three of these contracts independently contributed to more than 10% of Faneuil revenue, at 19.7%, 12.6%, and 11.4% for each contract.

For the year ended September 30, 2014, Faneuil had seven contracts in which each contract independently contributed to more than 5% of total revenue. In the aggregate, these contracts accounted for $110.7 million, or 83.3% of total Faneuil revenue. Two of these contracts independently contributed to more than 10% of revenue, at 23.0% and 16.6% for each contract.

Carpets

For the year ended September 30, 2015, Carpets received 58.4% of its revenue from three customers which accounted for 27.3%, 25.6%, and 5.5% of Carpets revenues, respectively, of which $0.5 million, $1.2 million, and $0.5 million, respectively, were included in accounts receivable as of September 30, 2015.

For the year ended September 30, 2014, Carpets received 72.6% of its revenue from four customers which accounted for 27.9%, 18.9%, 15.1% and 10.7% of Carpets revenues, respectively, of which $1.2 million, $0.7 million, $0.5 million, and $0.5 million, respectively, were included in accounts receivable as of September 30, 2014.

For the year ended September 30, 2015, Carpets had four vendors that accounted for 19.3%, 18.7%, 14.9% and 10.4% of its inventory purchases, of which approximately $0.5 million, $1.1 million, $0.2 million and $0.1 million, respectively, were included in accounts payable at September 30, 2015. The Company has negotiated agreements with various suppliers for similar products as well.

For the year ended September 30, 2014, Carpets had three vendors that accounted for approximately 26.0%, 16.6% and 13.2% of its inventory purchases, of which approximately $0.6 million, $0.4 and $0.4 million, respectively, were included in accounts payable at September 30, 2014.

Phoenix

For the period ended September 30, 2015, Phoenix had three customers that accounted for approximately 27.0%, 15.6%, and 13.2%, of its revenues, respectively, of which $2.6 million, $1.2 million, and $1.0 million, respectively, were included in accounts receivable as of September 30, 2015.

For the period ended September 30, 2015, Phoenix had two vendors that accounted for approximately 26.3% and 16.5% of its inventory purchases, of which approximately $0.3 million and $0.4 million, respectively, were included in accounts payable at September 30, 2015.

Business Segment Information

The following table shows the results of operations for the years ended September 30, 2015 and 2014, by operating segment.

	For the year Ended September 30, 2015	For the year Ended September 30, 2014
Net Revenue		
Faneuil	$ 149,624,810	$ 132,851,782
Carpets	44,571,476	16,752,980
Phoenix	15,750,293	-
Consolidated	209,946,579	149,604,762
Cost of revenue		
Faneuil	118,116,393	102,095,387
Carpets	37,032,419	13,824,516
Phoenix (includes $518,241 of depreciation)	10,125,974	-

	For the year Ended September 30, 2015	For the year Ended September 30, 2014
Consolidated	165,274,786	115,919,903
Selling, general and administrative expense		
Faneuil (includes $448,258 for loss on sale of assets)	17,056,704	12,245,765
Carpets	7,239,645	3,295,255
Phoenix	1,489,190	-
Consolidated	25,785,539	15,541,020
Depreciation and amortization		
Faneuil	5,591,265	4,150,342
Carpets	705,270	349,463
Phoenix	355,051	-
Consolidated	6,651,586	4,499,805
Segment operating profit		
Faneuil	8,860,448	14,360,288
Carpets	(405,858)	(716,254)
Phoenix	3,780,078	-
Consolidated	12,234,668	13,644,034
Parent company expenses	3,220,174	1,018,456
Income from operations	9,014,494	12,625,578

Net Revenue

Faneuil Net Revenue

Faneuil net revenue for the year ended September 30, 2015, was $149.6 million, an increase of $16.7 million, or 12.6%, over net revenue of $132.9 million for the year ended September 30, 2014. The increase in net revenue was attributable to $17.6 million in new and expanded contracts, and $5.8 million due to an additional 18 days of Faneuil's operating results included in the later period because of the timing of ALJ's acquisition of Faneuil. This increase was partially offset by a $4.0 million decrease in implementation revenue recognized over the contract term and a $2.6 million reduction resulting from customer contracts that concluded in 2015.

Carpets Net Revenue

Carpets net revenue for the year ended September 30, 2015 was $44.6 million, an increase of $27.8 million, or 166.1%, over net revenue of $16.8 million for the period from April 1, 2014 to September 30, 2014. The increase in net revenue was attributable to $20.0 million due to an additional six months of operating results due to the timing of the acquisition and $7.5 million of higher revenue to builder clients, including revenue related to sales of new cabinet products of $4.4 million. Carpets net revenue was positively impacted by an increase in cabinet sales and new customer acquisition. Additionally, some builders purchased additional products from us such as flooring, surfaces and cabinets. Some other builders have moved towards designating Carpets as a single source for flooring, granite and cabinets to improve operating efficiencies and obtain a single point of contact for products and installation, which has positively impacted Carpets net revenue.

Phoenix Net Revenue

Phoenix net revenue for the period from August 9, 2015 to September 30, 2015 was $15.8 million. Phoenix experiences fluctuations in its revenue throughout the year. The revenue reflected during this short period is not indicative of the annual revenue as the short period represents higher than typical revenues on an annualized basis.

Cost of Revenue

Faneuil Cost of Revenue

Faneuil cost of revenue for the year ended September 30, 2015 was $118.1 million, an increase of $16.0 million, or 15.7%, over cost of revenue of $102.1 million for the year ended September 30, 2014. The increase was attributable to $14.7 million of costs related to new and expanded customer contracts and $4.8 million due to an additional 18 days of Faneuil's operating results included in the later period because of the timing of ALJ's acquisition of Faneuil. This increase was partially offset by a $0.4 million decrease

in implementation costs recognized over the contract term, and a $3.1 million reduction resulting from customer contracts that concluded in 2015. Cost of revenue as a percentage of revenue was 78.9% and 76.8% for the years ended September 30, 2015 and 2014, respectively. The increase in cost of revenue as a percentage of revenue was a result of the reduction of higher margin implementation revenues for the year ended September 30, 2015 compared to the year ended September 30, 2014.

Carpet Cost of Revenue

Carpets cost of revenue for the year ended September 30, 2015 was $37.0 million, an increase of $23.2 million, or 168.1%, over cost of revenue of $13.8 million for the period from April 1, 2014 to September 30, 2014. The increase in cost of revenue was attributable to $16.8 million due to an additional six months of operating results due to the timing of the acquisition and $6.2 million of higher cost of revenue related to higher revenues to builder clients. Cost of revenue as a percentage of revenue remained relatively consistent at 83.1% and 82.5% for the year ended September 30, 2015 and for the period from April 1, 2014 to September 30, 2014, respectively. Carpets is focused on improving its margins over the next year within its product segments by increasing operating efficiencies, moving towards automation in its granite facility, and selling higher margin products such as cabinets.

Phoenix Cost of Revenue

Phoenix cost of revenue for the period from August 9, 2015 to September 30, 2015 was $10.1 million, which included $0.5 million in depreciation and amortization expense.

Selling, General and Administrative Expense

Faneuil Selling, General and Administrative Expense

Fanueil selling, general and administrative expense for the year ended September 30, 2015 was $17.1 million, an increase of $4.9 million, or 40.2% over selling, general and administrative expense of $12.2 million for the year ended September 30, 2014. Selling, general and administrative expense as a percentage of revenue was 11.4% and 9.2% for the years ended September 30, 2015 and 2014, respectively. The absolute dollar increase of $4.9 million as well as the increase as a percentage of revenue was primarily attributable to an increase of $2.1 million in facility expenses, $0.9 million in professional/consulting services, $0.6 million in communications expenses, $0.4 million related to the loss on sale of assets, $0.3 million in licenses and fees, $0.2 million in travel expenses and $0.2 million in technology expenses. The increase in the facility expense was primarily attributable to new health care contract. Our facility expenses fluctuate based on the demands from new contracts and the expansion and contraction of existing contracts. The increase in professional/consulting services expense was attributable to subcontractor fees and legal fees related to the bid protests and lawsuits.

Carpets Selling, General and Administrative Expense

Carpets selling, general and administrative expense for the year ended September 30, 2015 was $7.2 million, an increase of $3.9 million, or 118.2% over selling, general and administrative expense of $3.3 million for the period from April 1, 2014 to September 30, 2014. The absolute dollar increase was primarily attributable to $3.1 million due to an additional six months of operating results due to the timing of the acquisition and $0.7 million in salaries related to increases in headcount related to our cabinet division and supporting higher revenues. Selling, general and administrative expense as a percentage of revenue was 16.2% and 19.7% for the years ended September 30, 2015 and 2014, respectively. The decrease as a percentage of revenue was attributable to fixed facilities expenses leveraged over increased net revenue.

Phoenix Selling, General and Administrative Expense

Phoenix selling, general and administrative expense for the period from August 9, 2015 to September 30, 2015 was $1.5 million.

ALJ Selling, General and Administrative Expense

ALJ selling, general and administrative expense for the year ended September 30, 2015 was $3.2 million, an increase of $2.2 million, or 220% over selling, general and administrative expense of $1.0 million for the year ended September 30, 2014. The increase was primarily attributable to an increase to non-cash stock-based compensation expenses of $1.2 million and professional fees associated with the acquisition of Phoenix of $0.8 million. The Company expects to continue to recognize

non-cash stock-based compensation expenses associated with the prior issuance of stock options and restricted stock. Additionally, ALJ expects to incur increased selling, general and administrative expenses associated with the cost of complying with SEC and NASDAQ requirements, and higher director compensation fees associated with our Board of Directors and other governance committees.

Depreciation and Amortization – Selling, General and Administrative

Faneuil Depreciation and Amortization

Faneuil depreciation and amortization expense for the year ended September 30, 2015 was $5.6 million, an increase of $1.4 million, or 33.3% over depreciation and amortization expense of $4.2 million for the year ended September 30, 2014. The increase was primarily attributable to Faneuil's expanded business and the additional 18 days during the year ended September 30, 2015.

Carpets Depreciation and Amortization

Carpets depreciation and amortization expense for the year ended September 30, 2015 was $0.7 million, an increase of $0.4 million, or 101.8% over depreciation and amortization expense of $0.3 million for the period from April 1, 2014 to September 30, 2014. The increase was primarily attributable to an additional six months of operating results due to the timing of the acquisition. As Carpets begins to increase the automation within its granite facility, it expects to experience an increase in depreciation expense.

Phoenix Depreciation and Amortization

Phoenix depreciation and amortization expense for the period from August 9, 2015 to September 30, 2015 was $0.4 million.

Interest Expense

Interest expense for the year ended September 30, 2015 was $2.2 million, an increase of $0.9 million, or 69.2% over for the interest expense of $1.3 million for the year ended September 30, 2014. The increase was primarily attributable to the interest expense accrued and partially paid on the Cerberus $105.0 million term loan and the amortization of the related debt issuance costs. We expect our interest expense to increase as we have substantially increased our average outstanding borrowings and our borrowing rates.

Income Taxes

Income tax benefit for the year ended September 30, 2015 was $5.5 million, an increase of $1.0 million, or 22.2%, compared to income tax benefit of $4.5 million for the year ended September 30, 2014. The change was primarily attributable to a decrease in the valuation allowance related to the recording of a deferred tax asset for the partial recognition of net operating losses. To the extent that we continue to recognize taxable income, we expect to utilize our net operating losses and continue to recognize a decrease in our valuation allowance.

Liquidity and Capital Resources

In summary, our cash flows for each period were as follows (*in thousands*):

	Three Months Ended December 31,		Year Ended September 30,	
	2015	**2014**	**2015**	**2014**
Cash provided by operating activities	$ 1,011	$(5,059)	$ 11,402	$ 14,278
Cash (used) by investing activities	(581)	(3,054)	(95,308)	(28,608)
Cash provided (used) by financing activities	(1,718)	1,772	78,931	(3,417)
Net decrease in cash and cash equivalents	$(1,288)	$(6,341)	$ (4,975)	$ (17,747)

At December 31, 2015, our principal sources of liquidity included cash and cash equivalents of $3.8 million and an available borrowing capacity of $15.2 million on our line of credit. We had no significant cash outlays, except as part of our normal operations, during the three months ended December 31, 2015 and 2014.

At September 30, 2015, our principal sources of liquidity included cash and cash equivalents of $5.1 million and an available borrowing capacity of $19.1 million on our line of credit.

On July 11, 2015, ALJ entered into a stock purchase agreement with Visant Corporation to acquire 100% of the common stock of Phoenix, effective August 9, 2015. The aggregate consideration for the acquisition, subject to certain closing adjustments, was $88.3 million.

On August 14, 2015, ALJ entered into a financing agreement with Cerberus Business Finance, LLC ("Cerberus"), to borrow $105.0 million in a term loan ("Cerberus Term Loan") and have available up to $30.0 million in a revolver ("Cerberus/PNC Revolver"), of which $2.2 million was drawn at the close of the stock purchase of Phoenix. The proceeds of these facilities were used together with cash on hand plus the proceeds from the sale of ALJ stock described below to fund the acquisition and refinance the outstanding obligations of ALJ, Faneuil and Carpets and to provide working capital facilities to ALJ and all three of its subsidiaries.

On July 10, 2015, Marc Reisch, the Chairman of Phoenix purchased 400,000 shares of common stock and Kevin Hayden, the Chief Operating Officer of Phoenix purchased 50,000 shares of common stock of ALJ in a private placement for an aggregate consideration of $1.7 million.

On August 14, 2015, ALJ refinanced its outstanding borrowings and agreements with M&T Bank, including the Faneuil Term Loan for $15.9 million, Carpets Revolver for $2.2 million, ALJ Revolver for $0.3 million and Faneuil Revolver for $0, with Cerberus and PNC.

Since October 1, 2014, ALJ has used $1.2 million to repurchase 290,787 shares of its common stock under its repurchase program at an average price of $4.02 per share.

Operating Activities

For the three months ended December 31, 2015, we generated $1.0 million in operating activities as a result of $0.3 million net income, $3.3 million of net non-cash expenses, and $2.6 million net cash used by changes in operating assets and liabilities.

For the three months ended December 31, 2014, we used $5.1 million in operating activities as a result of $3.0 million net income, $1.4 million of net non-cash expenses, and $9.5 million net cash used by changes in operating assets and liabilities.

For the year ended September 30, 2015, we generated $11.4 million in operating activities as a result of $12.3 million net income, $2.7 million of net non-cash expenses, and $3.6 million net cash used by changes in operating assets and liabilities.

For the year ended September 30, 2014, we generated $14.3 million in operating activities as a result of $15.9 million net income, $1.5 million of net non-cash expenses, and $3.1 million net cash used by changes in operating assets and liabilities.

Investing Activities

For the three months ended December 31, 2015, we used $0.6 million in investing activities related to capital equipment purchases during the normal course of operations.

For the year three months ended December 31, 2014, we used $3.1 million in investing activities related to the setup of Faneuil's new customer-support facilities.

For the year ended September 30, 2015, we used $95.3 million in investing activities, primarily attributable to the $88.3 million acquisition of Phoenix and $7.1 million of capital equipment purchases.

For the year ended September 30, 2014, we used $28.6 million in investing activities, primarily attributable to the $19.1 million acquisition of Faneuil, $5.2 million acquisition of Carpets and $4.3 million acquisition of capital equipment purchases.

Financing Activities

For the three months ended December 31, 2015, we used $1.7 million in financing activities, which included a $2.0 million payment on our Cerberus Term Loan, payments on capital leases, repurchase of common stock, and net advances on our Cerberus/PNC Revolver of $0.9 million.

For the three months ended December 31, 2014, we generated $1.8 million in financing activities, as a result of $3.0 million

proceeds from our line of credit, partially offset by $1.2 million payments on capital leases.

For the year ended September 30, 2015, we generated $78.9 million in financing activities, primarily related to proceeds from the $105.0 million term note from Cerberus and $1.7 million from the sale of ALJ stock, partially offset by payments of $19.0 million to retire the term note with M&T Bank at Faneuil and $2.0 million to retire the term note with M&T Bank at ALJ, $3.8 million in debt issuance costs associated with the Cerberus Term Note, $2.0 million of principal payment towards the Cerberus Term Note, and $1.2 million related to the repurchase of our stock.

For the year ended September 30, 2014, we used $3.4 million in financing activities as a result of repayments on the Harland Clarke Note of $25.0 million by Faneuil, partially offset by proceeds of two term loans from M&T Bank for $19.0 million to Faneuil and $2.0 million to ALJ and proceeds of $2.2 million from the sale of sale of ALJ stock.

For the year ended September 30, 2014, we used $3.4 million in financing activities, primarily attributable to repayments on the Harland Clarke Note of $25.0 million by Faneuil, partially offset by $21.0 million proceeds from a term loan and $2.2 million for the sale of ALJ common stock.

Cash and Working Capital Requirements

We believe that current cash and other sources of liquidity are sufficient to fund normal operations for the next 12 months. However, to the extent that our estimates are inaccurate or our assumptions are incorrect, we may not have sufficient cash resources to fund our operations. In such event, we may have to seek additional financing for the business.

Contractual Obligations

The following tables summarizes our significant contractual obligations as of December 31, 2015 and September 30, 2015, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (*in thousands*):

	Payments due by Period (as of December 31, 2015)				
	Total	Less Than One Year	One – Three Years	Four – Five Years	More than Five Years
Line of credit[1]	$ 908	$ –	$ 908	$ –	$ –
Term loan payable[2]	101,063	7,875	23,625	69,563	–
Operating lease obligations	12,361	4,168	7,067	1,126	–
Capital lease obligations	2,258	1,017	1,241	–	–
Other long-term liabilities[3]	4,872	969	3,903		
Total contractual cash obligations	$121,462	$14,029	$36,744	$70,689	$ –

	Payments due by Period (as of September 30, 2015)				
	Total	Less Than One Year	One – Three Years	Four – Five Years	More than Five Years
Line of credit[1]	$ 21	$ –	$ 21	$ –	$ –
Term loan payable[2]	103,031	7,875	23,625	71,531	–
Operating lease obligations	10,970	3,631	6,271	613	455
Capital lease obligations	1,938	830	1,108	–	–
Other long-term liabilities[3]	4,610	1,027	3,583	–	–
Total contractual cash obligations	$120,570	$13,363	$34,608	$72,144	$455

[1] Outstanding balance on our Cerberus/PNC Revolver (discussed above).

[2] Outstanding balance on our Cerberus Term Loan (discussed above).

Hereafter, the Cerberus/PNC Revolver and Cerberus Term Loan are collectively referred to as “Cerberus Debt.” All borrowings under the Cerberus Debt are secured by substantially all of our assets, and are subject to certain other terms. The Cerberus Debt includes limitations on the ability, among other things, to incur debt, to grant liens, to make certain investments, to make certain restricted payments such as dividend payments, and to dispose of assets, as well as requirements to meet some affirmative and negative covenants. Our borrowings under the Cerberus Term Loan are limited to eligible accounts receivable (as defined in the agreement).

The Cerberus Term Loan accrues interest at an annual rate equal to either LIBOR plus 6.5% or the Reference Rate (as defined in the agreement), at our discretion. For the three months ended December 31, 2015, the Cerberus Term Loan accrued interest at

an annual rate of 7.5%. Interest payments are due in arrears on the first day of each month and a quarterly principal payment against the Cerberus Term Loan is due on the last day of each fiscal quarter in the amount of approximately $2.0 million, with a balloon payment due on the maturity date of August 14, 2020. We must pay an annual excess cash flow principal payment against the Cerberus Term Loan equal to 75% of our excess cash flow, as defined in the loan documents, beginning with the year ending September 30, 2016. There is a prepayment penalty equal to 3%, 2% and 1% of any amounts prepaid within the first, second and third years of the loan, respectively. We may make a one-time payment against the loan with no penalty up to $10 million.

The Cerberus/PNC Revolver accrues interest on the outstanding balance at an annual rate equal to either LIBOR plus 6.5% or our Reference Rate (as defined in the Cerberus Term Loan agreement), at our discretion. Interest payments are due in arrears on the first day of each month. We have the option to prepay (and re-borrow) the outstanding balance of the Cerberus/PNC Revolver, without penalty. Each of our subsidiaries can borrow up to $30.0 million in the aggregate up to an amount equal to 85% of eligible receivables. The Cerberus/PNC Revolver carries an unused fee of 0.5% of the total amounts undrawn under the credit facility. Additionally, the Cerberus/PNC Revolver provides for a sublimit for letters of credit up to $15.0 million. Faneuil had a $2.2 million letter of credit under the agreement as of December 31, 2015.

As of December 31, 2015, we were in compliance with all debt covenants.

(3) Amounts represent future cash payments to satisfy our short- and long-term workers' compensation reserve and other long-term liabilities recorded on our consolidated balance sheets.

Off-Balance Sheet Arrangements

As of December 31, 2015 and September 30, 2015, we had two types of off-balance sheet arrangements:

Surety Bonds

As part of Faneuil's normal course of operations, certain customers require surety bonds guaranteeing the performance of a contract. As of December 31, 2015 and September 30, 2015, the face value of such surety bonds, which represents the maximum cash payments that Faneuil would have to make under certain circumstances of non-performance, was approximately $20.7 million and $19.0 million, respectively.

Letter of Credit

Faneuil had a letter of credit for $2.2 million and $1.0 million as of December 31, 2015 and September 30, 2015, respectively.

Critical Accounting Policies and Estimates

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often resulting from the need to make estimates on matters that are inherently uncertain.

We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

Impairment of Goodwill, Other Indefinite-Lived Assets and Long-Lived Assets

Goodwill and other indefinite-lived intangible assets are tested annually for impairment and in interim periods if certain events occur indicating that the carrying amounts may be impaired. If a qualitative assessment is used and we determine that the fair value of a reporting unit or indefinite-lived intangible asset is more likely than not (*i.e.,* a likelihood of more than 50%) less than its carrying amount, a quantitative impairment test will be performed. If goodwill is quantitatively assessed for impairment, a two-step approach is applied. First, we compare the estimated fair value of the reporting unit in which the goodwill resides to its carrying value. The second step, if necessary, measures the amount of impairment, if any, by comparing the implied fair value of goodwill to its carrying value. Other indefinite-lived intangible assets are quantitatively assessed for impairment, if necessary, by comparing their estimated fair values to their carrying values. If the carrying value exceeds the fair value, the difference is recorded as an impairment.

Long-lived assets, such as property, plant and equipment and intangible assets subject to amortization, are reviewed for impairment when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset or asset group to estimated undiscounted future cash flows expected to be generated by the asset or asset group. If the carrying amount of an asset or asset group exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset or asset group exceeds the estimated fair value of the asset or asset group. Long-lived assets to be disposed of by sale are

reported at the lower of their carrying amounts or their estimated fair values less costs to sell and are not depreciated.

Revenue Recognition

Faneuil. Revenues associated with outsourcing services are generally recognized by Faneuil during the period in which the services are rendered. Revenues from time and material contracts are recognized at the contracted rates as labor hours and direct expenses are incurred and charged to costs of revenue. Revenue for call center contracts is recognized at the time calls are received based on the contracted rate per call. Revenues are generally based on staff hours, call time, call volume or number of transactions processed, and are presented net of any allowance or discounts. Payments for development activities are recognized as revenue when earned, over the period of effort.

Revenues from non-refundable up-front payments attributable to contract implementation, though not tied to achieving a specific performance milestone, are recognized over the initial term of the contract. At-risk milestone payments, which are based on achieving a specific performance milestone, are recognized as revenue when the milestone is achieved and the related payment is due, providing there is no future service obligation associated with that milestone.

Deferred revenue represents amounts billed to the customer in excess of amounts earned. In situations where Faneuil receives payment in advance of the performance of services, such amounts are recorded as deferred revenue and recognized as revenue during the period in which the related services are performed.

Receipt of funding under grant agreements are evaluated for appropriate recognition as revenue, based on the specific terms of the related grant or agreement. Grant funding received in advance of compliance with the grant conditions is recorded as deferred revenue. Faneuil recognizes grant income once it has complied with the conditions attached to the grant received.

Carpets. Carpets recognizes revenue and invoices customers upon completion of installation of product. Carpets is not obligated to perform significant activities after installation is complete. Payments received by customers prior to installation are recorded as customer deposits. Sales taxes collected and remitted are recorded on a net basis.

For commercial projects, Carpets recognizes revenue based on the cost-to-cost method under the percentage of completion method. Under the cost-to-cost method, the Company analyzes the contract cost incurred to date to the total expected contract cost. For contracts with anticipated losses at completion, a provision is recorded when the loss becomes known.

Phoenix. Revenue is recognized (1) when products are shipped (if shipped “FOB” shipping point) (2) when products are delivered (if shipped “FOB” destination), and (3) as services are performed as determined by contractual arrangement, but in all cases only when risk of loss has transferred to the customer and Phoenix has no further performance obligations.

Income Taxes

We use the asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax-credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets are reduced by the valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Our judgments relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by tax authorities. We file income tax returns in the U.S. federal jurisdictions and various state jurisdictions and are subject to U.S. federal tax and state tax examinations for years post June 2011 and certain other years. Our judgments relative to the value of deferred tax assets and liabilities take into account estimates of the amount of future taxable income. Actual operating results and the underlying amount of income in future years could render current estimates of recoverable net deferred taxes inaccurate. Any of the judgments mentioned above could cause

actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations.

If we take a recognized tax position or have taken a recognized tax position on a tax return that more likely than not would be sustained upon examination by tax authorities, then we will recognize the potential asset or liability in the financial statements. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. We believe that we have appropriate support for the income tax positions taken and to be taken on its tax returns and that our accruals for tax liabilities are adequate for all open years on assessment of many factors including past experience and interpretation of tax law applied to the facts of each matter.

Insurance Reserves

Faneuil. Faneuil maintains general liability insurance coverage, which is subject to certain deductibles. Faneuil is self-insured for workers' compensation claims up to $250,000 per incident, and maintains insurance coverage for costs above the specified limit. Faneuil is self-insured for health insurance claims up to $150,000 per incident, and maintains insurance coverage for costs above the specified limit.

Phoenix. Before the acquisition of Phoenix by ALJ, Phoenix was self-insured for worker's compensation under its parent company for claims up to $500,000 per incident, and maintains coverage for costs above the specified limit. After the acquisition, the Phoenix changed to a fully insured plan.

Reserves have been provided for worker's compensation and health claims based upon management's judgment of insurance coverages and third party actuarial analysis.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Although actual results could differ from those estimates, such estimates are developed based on the best information available to management and management's best judgments at the time. Significant estimates and assumptions by management are used for, but are not limited to, determining the fair value of assets and liabilities, including intangible assets acquired and allocation of purchase price, useful lives, carrying values and recoverability of long-lived and intangible assets, the recoverability of goodwill, the realizability of deferred tax assets, stock-based compensation, the allowance for doubtful accounts and inventory reserves, and calculation of insurance reserves.

Stock-Based Compensation

We recognize compensation expense for our equity awards on a straight-line basis over the requisite service period of the award based on the estimated portion of the award that is expected to vest and applies estimated forfeiture rates based on analyses of historical data, including termination patterns and other factors. We use the quoted closing market price of our common stock on the grant date to measure the fair value of restricted stock awards and the Black-Scholes option pricing model to measure the fair value of stock option awards. The expected volatility is based on historical volatilities of our common stock over the most recent period commensurate with the estimated expected term of the awards. Where volatility was not available, we use comparable companies with the estimated expected term. The expected term of an award is equal to the midpoint between the vesting date and the end of the contractual term of the award. The risk-free interest rate is based on the rate on U.S. Treasury securities with maturities consistent with the estimated expected term of the awards. We have not paid dividends and do not anticipate paying a cash dividend in the foreseeable future and, accordingly, we use an expected dividend yield of zero. Stock-based compensation cost for restricted stock awards and restricted stock units are measured based on the fair market value of our common stock at the date of grant.