Transcript of
Staffing 360 Solutions, Inc.
Third Quarter 2018 Financial Results Conference Call
November 19, 2018

Participants

Brendan Flood - Chairman & Chief Executive Officer
David Faiman – Chief Financial Officer

Analysts

William Gregozeski, Greenridge Global
Zach Star, Private Investor

Presentation

Operator
Greetings, ladies and gentlemen. Welcome to the Staffing 360 Solutions Fiscal Third Quarter 2018 Earnings conference call. At this time all participants are in listen only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce Brendan Flood, Chairman and Chief Executive Officer of Staffing 360 Solutions. Mr. Flood, you may begin.

Brendan Flood – Chairman & Chief Financial Offer.
Thank you, Operator, and thank you to everyone who has joined us for Staffing 360's Fiscal Third Quarter 2018 Earnings Conference Call. I'm joined today by David Faiman, our Chief Financial Officer.

I want to bring to your attention that a webcast and replay of this conference call is available by following the link contained on the bottom of the press release announcing this call, and that this will also be available on Staffing 360's website, www.staffing360solutions.com.

Before we get started, I'll take a moment to read the Safe Harbor Statement regarding today's call. This conference call will contain forward-looking statements within the meaning of the U.S. federal securities laws concerning Staffing 360 Solutions Inc. The forward-looking statements are subject to a number of significant risks and uncertainties, and our actual results may differ materially. Please refer to the Company's filings with the SEC which contain and identify important risks and other factors that may cause Staffing 360's actual results to differ from those contained in our forward-looking statements.

All forward-looking statements are made as of today, November 19, 2018, and Staffing 360 Solutions expressly disclaims any obligation to revise or to update any forward-looking statements after the date of this conference call.

During these prepared comments we may make reference to certain non-GAAP measurements such as Adjusted EBITDA. Where applicable, we have provided reconciliations of these non-GAAP measures to the most directly comparable GAAP measure.

Now, with that said, I will start my remarks with an overview of our financial and operational third quarter 2018 performance, recent business developments and our strategy going forward. Then I will hand the call over to David Faiman to discuss our financial statements for the quarter before opening the line for questions.

The past four months or so have seen a number of major developments in the group. We have set new record levels for revenue and gross profit, continued our trend of being EBITDA positive, reached a new high in our Adjusted EBITDA numbers, closed another acquisition—this time in North Carolina with the acquisition of Key Resources Inc.—and returned the business to compliance with NASDAQ market listing requirements.

We were able to achieve substantial growth in revenues and gross profits of 42% and 31%, respectively, over the same quarter of 2017. Specifically, our Q3 revenue was $71.3 million and gross profit was $12.5 million. As I mentioned, both of these were record numbers for us. Gross margin of 17.5% was down from 19% in the prior year, as our RPO of Clement May, which operates at lower gross margins but at a high conversion rate from gross profit to EBITDA, has been a huge success for us. Additionally, the new acquisition was in the light industrial space where gross margins are typically lower than in our professional staffing businesses. Adjusted EBITDA of $2.5 million showed a 21% increase over the same period last year.

The management realignment of our business, which has been in effect since early this year, has continued to drive benefits as our businesses are more focused on growth but are also working very effectively together. The integration of support services across numerous brands has allowed us to leverage that cost base and talent more effectively than we were able to do when we were a smaller company. The impact of these initiatives and costs that we have removed from the company will show more clearly in the coming quarters.

We are operating in some challenging environments where unemployment rates are trending towards zero, and where we are seeing a number of our contractors being converted to permanent employees by our clients. It has had some impact on revenues but it is, perversely, a credit to our business that our candidates are strong enough and talented enough to be desired by our clients to fill permanent roles.

During the course of last week we came to an agreement with Jackson Investment Group to convert $13 million of its term loan into preference shares. This is another reflection of Jackson's belief in the Company and faith in the management team. As a result of this conversion, we are again in compliance with NASDAQ's listing standards.

We have continued to talk to possible M&A targets and maintain our view that the quality of businesses available in the market is very high, and we reaffirm our intention to become a $500 million profitable international staffing group within the next 12 months.

I will now hand the call over to David Faiman, our Chief Financial Officer for the financials. Dave?

David Faiman - CFO

Thank you, Brendan, and good morning everyone. For the third quarter of 2018 revenue of $71.3 million increased 41.7% over the prior year third quarter of $50.3 million, and sequentially up 19.4%. The increase in revenue included $26.9 million from the acquisitions of CBS Butler and firstPRO that closed in September of 2017, Clement May Limited which closed in June of 2018, and Key Resources Inc. which closed in September of 2018. This is partly offset by a $4.4 million decline attributable to the divestiture of the PeopleServe business in June of 2018, and organic decline of $1.5 million from the remaining core business, mainly attributable to conversions of temporary workers to permanent workers at our clients.

Revenue during the quarter was comprised of $68.7 million of temporary contract revenue and $2.7 million of permanent placement revenue, compared with $49 million and $1.4 million of temporary and permanent placement revenue in Q3 of 2017, respectively. The temporary contract revenue in Q3 of 2018 is now $5,283 per week, up from $3,767 per week in the prior year third quarter, and we now have over 6,000 temporary workers and contractors on billing versus 3,300 last December.

Gross profit for the third quarter of 2018 of $12.5 million increased $2.9 million or 30.5% over the prior year and up 5.2%, sequentially. Gross margin was 17.5% versus 19% in the prior year third quarter, partly driven by the mix reflecting the addition of the RPO business in Clement May, and the acquisition of Key Resource Inc. which operates in the light industrial space, both with lower gross margins than our professional staffing businesses. Additionally, prior year gross profit includes approximately $0.5 million of higher workers compensation insurance benefit that did not repeat in the current year.

Operating expenses were $11.8 million, or $2.2 million higher versus the prior year, primarily driven by the four acquisitions. These additional costs were partly offset by lower non-recurring legal costs, lower variable costs from lower organic revenue, savings attributable to synergies within the subsidiaries, and the PeopleServe divestiture that occurred in the second quarter. Income from operations in the quarter was $658,000 versus a loss of $13,000 in the prior year comparative quarter.

Other expenses for the third quarter was $2.6 million, a decrease of 64.6% from $7.4 million in Q3 of 2017. The decrease was mainly driven by a loss and extinguishment of debt in the third quarter of 2017, associated with the refinancing of our balance sheet, coupled with loss in 2017 from fair valuing warrants. These were partly offset by higher interest and higher debt and remeasuring the Company's intercompany note. This performance translated into a net loss of $2 million compared to a net loss of $7.7 million in the prior year.

Adding back the non-cash adjustments and non-recurring cash costs, our Adjusted EBITDA grew to $2.5 million from $2.1 million in the prior year comparative quarter, a 21% improvement and our third consecutive quarter of positive EBITDA. The trailing 12 months Adjusted EBITDA as a percentage of gross profit has also improved by 110 basis points. Including the four acquisitions on a pro forma basis as if they have been owned for the entire year, our trailing 12-month Adjusted EBITDA is now $12.3 million.

On a year-to-date basis revenue increased 40.3% to $186.8 million as compared to $133.2 million for the nine months in the prior year. Of that growth, $64.9 million was from the acquisition of CBS Butler, firstPRO, Clement May and Key Resources Inc. and $1.2 million was from favorable foreign currency translation. This was partially offset by a decline of $6.4 million attributable to PeopleServe and an organic decline of $6 million from the remaining core business, more than half of which occurred during the first quarter. During the first nine months, revenue was comprised of $178.5 million of temporary contract revenue and $8.3 million of permanent placement revenue compared with $130.2 million and $3 million for the prior year period, respectively.

Gross profit for the nine months ended September of 2018 was $36 million, an increase of 44.8% over $24.8 million for the prior year, representing gross margin of 19.2% and 18.6% for each period, respectively. Gross profit growth and gross margin improvement is attributable to the impact of the acquisitions, partially offset by lower savings from workers compensation insurance versus the savings realized in the corresponding period in 2017, and the divesture of the non-strategic PeopleServe business.

Operating expenses for the first nine months was $35.6 million, an increase of 44.2% over $24.7 million for the prior year period. Of that increase, 42.6% can be attributable to acquisitions of CBS Butler, firstPRO, Clement May and Key Resources Inc. The remaining increase is primarily stemming from other non-recurring costs and other costs associated with acquisitions, capital raising and non-cash charges or credits. This is partly offset by savings that are materializing which are attributable to synergies in the subsidiaries, cost saving initiatives and the PeopleServe divesture.

Other expenses of $5.6 million decreased almost 50% from $11 million last year. Although interest expense increased $4.3 million from financing of the acquisitions, amortization of debt discount and deferred financing costs decreased by $2.2 million, also attributable to the refinancing. The prior year includes a loss and extinguishment of debt of $6.1 million, the current year includes a higher gain of $1.4 million from fair valuing of warrants, a gain of $0.2 million from the sale of PeopleServe, a loss of $0.3 from remeasuring the Company's intercompany loan, and Other income of $0.3 million from the investment of the Company's workers comp collateral.

The year-to-date EBITDA was $3.7 million compared to EBITDA loss of $4.2 million in the prior year with positive EBITDA in every quarter in 2018 so far.

Operator, we'll now turn the call over to Q&A session.

Question-and-Answer Session

Operator
Thank you. [Operator Instructions] Our first question comes from Our first question comes from William Gregozeski of Greenridge Global. Please proceed with your question.

William Gregozeski:

With all the different growth initiatives, the cross-selling and everything you guys have talked about this year, when will we start seeing that show up in organic growth in the results?

Brendan Flood:

Bill, this is Brendan. It's partly already happening because we have Clement May working with CBS Butler, CBS Butler working with the JM Group, Monroe Professional Staffing working with Lighthouse Placement Services, firstPRO working with Lighthouse Placement Services. It's also kind of disappeared a little bit because of the impact of the conversion of the contractors into permanent employees. We've had 240 contractors have converted in the last three months which equates to about as much as $3 million of revenue per quarter, so it's kind of getting masked. When Dave said that the organic growth was down by 1.6, $3 million of it was these conversion of temps into permanent employees. So we are seeing some of it; it's just getting masked at the moment a little bit.

William Gregozeski:

Okay, all right. What is the earn-out going to be that’s due for CBSbutler?

Brendan Flood:

We're still going through the process of calculating it. They have delivered on any calculation the vast majority of what they said they were going to do, so I think it's going to resolve itself at some point during the course of next four to six weeks.

William Gregozeski:

Okay.

Brendan Flood:

But the agreed number was £4.2 million Sterling and my expectation is that it will be most of that.

William Gregozeski:

Okay. How are you guys going to finance that?

Brendan Flood:

We're lining up the finance now, Bill, but we are fully confident of making sure that we can fund it.

William Gregozeski:

Okay, great. Thank you, guys.

Operator:

Our next question comes from Zach Star, a private investor.

Zach Star:

Yes. Hi, guys. How much debt is on the Company right now? I never heard that number.

David Faiman:

After the debt exchange that we did on Thursday evening, there is about $56 million, $57 million of debt that includes the Company's ABLs, asset-based lending.

Zach Star:

Okay. What is the meaning behind the $500 million of top line sales? Why would you—would you ever just consider just—it seems like you're gaining some synergies now. Why wouldn't we stop? Put the brakes on acquisitions, especially as you mentioned it is a tough environment right now because of the tight unemployment, and we could just enjoy those synergies now and look for a higher EBITDA, even maybe to positive cash flow?

Brendan Flood:

It's a good question. The $500 million number makes us one of the more material players in the industry, but if you look at the geographic spread of what we have currently, in the United States particularly, there's quite a spread, so we need to become a little bit bigger in order to leverage those support service costs even more, and in order to align the management team far more effectively than it probably currently is. We're spread all the way from New Hampshire down to Georgia, so we just need a little bit more girth so that we can take out some more costs.

Zach Star:

Thanks. If I can just one more question—with this tight labor market, are you pivoting and trying to—for lack of better word—poach high level execs for more profitable fees to other companies?

Brendan Flood:

If I hear you correctly, you mean are we moving further up the food chain in terms of the type of candidates that we're placing. Is that what you mean?

Zach Star:

Yes.

Brendan Flood:

Okay. We're pretty far up the food chain as far as our firstPRO business is concerned in Atlanta, Georgia. We're also moving further up the food chain across our JM Group and CBS Butler businesses in the UK, but what we're also seeing is that there is a bigger demand for permanent placements or direct hire placements in both geographies, so we've concentrated a little bit more than we normally would on the permanent hire business in both geographies and we should see that coming through in the next three, four months.

Zach Star:

Okay, great. Thanks guys.

Operator:

Once again, if you have a question, please press star, then one.

This concludes the question-and-answer session. I would like to hand the call back over to Mr. Flood for any closing remarks.

Brendan Flood:

Okay. Thank you, Operator. As we continue to drive improvements to our operational performance, and to have removed the uncertainty hanging over our listing with NASDAQ, we have engaged a new investor relations firm in Bibicoff + MacInnis run by Harvey Bibicoff and Terri MacInnis, to help in expanding our story to a greater audience in order to start to move our stock price to an acceptable and normal level in relation to our industry peers.

As a management team, we continue to remain committed to growth and revenue, to growth and earnings, and to growth and shareholder value. Thank you, all, and we look forward to speaking to you again soon, and happy holidays to all of you in the United States.

Operator, that is the end of our call.

Operator:

Thank you. This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.