Transcript of
Staffing 360 Solutions, Inc.
Second Quarter 2018 Financial Results Conference Call
August 15, 2018

Participants

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

Analysts

Tucker Andersen - Above All Advisors
Matt Salazar - Wells Fargo

Presentation

Operator

Greetings, ladies and gentlemen, and welcome to the Staffing 360 Solutions Fiscal Second Quarter 2018 Earnings Conference Call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

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 are 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 August 15, 2018, and Staffing 306 Solutions expressly disclaims any obligation to revise or update any forward-looking statement after the date of this conference call.

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

It is now my pleasure to introduce Brendan Flood, Chairman and Chief Executive Officer of Staffing 360 Solutions. Please go ahead.

Brendan Flood – Chairman & Chief Financial Offer.
Thank you, Dana, and thank you to everyone who has joined us for Staffing 360's fiscal second 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

I will start my remarks with an overview of our financial and operational second 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 and first half of the year before the lines open for questions.

The 2018 second quarter was another record quarter in terms of revenue and gross profit, marking a significant step forward in our journey of reaching $500 million in annualized revenues.

Revenue grew by 42% to almost $60 million and gross profit grew by 50% to almost $12 million. Also this is the second consecutive quarter of positive EBITDA on an unadjusted basis.

From a very early stage in our journey, we have commented that the integration of the various acquisitions would only start to show material impacts once we reached a certain size. With the three acquisitions that we have made since September 2017, *first*PRO in Atlanta and CBSbutler and Clement May in London we have reached that mark and have been performing many integration exercises since the beginning of the current financial year.

Focusing of the business into three distinct business streams is having a positive impact on our ability to cross-sell our services and to get our people working together more effectively than has been possible in the past. We have managed to share services across business units, share costs and to reduce operating costs in total and per business unit. These cost saving initiatives, once fully executed, are expected to reduce our overhead base by $3 million to $4 million per annum.

Additionally, we strengthened the senior management team with the elevation of Paul Polito to President, Commercial Staffing and with the appointments of Mark Darby as President, Professional Staffing U.K. and Alicia Barker as our Chief Operating Officer.

During 2018, we divested the PeopleServe business to management. For a number of quarters, we have seen negative growth in this business and we took the strategic view that our energies are best spent elsewhere.

The acquisition of Clement May in London has allowed us to move into the RPO market for the first time with any real size. The Clement May team moved into our existing London office to join our team from Longbridge and The JM Group from the first day following the acquisition and we are already seeing job flow moving from Clement May's relationships to both CBSbutler and to Longbridge, with Chris Rowbotham, Managing Director of Clement May now also managing the Longbridge business.

In July, we opened our 18th office in Greenville-Spartanburg in South Carolina, our second office in that state. Greenville is one of the fastest growing cities in the United States.

This gives a flavor of the activity within the group, but looking forward, we will continue to look for appropriate acquisitions. We will continue with the process of streamlining our business with improvements in our EBITDA and adjusted EBITDA numbers. And we also expect to continue setting new records into the third quarter and beyond.

With that said, 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 second quarter of 2018 revenue of $59.7 million was an increase of 41.8% over the prior year second quarter of $42.1 million and sequentially up 7.1%. Revenue during this quarter included $20.1 million from the acquisitions of CBSbutler and *first*PRO that we completed in September of 2017, and Clemet May, which we closed in June of 2018.

In addition, $0.4 million arose from favorable foreign currency translation. This was partially offset by a decline attributable to our PeopleServe business which we divested during the quarter of $1.6 million and $1.4 million decline in the remaining core business.

Revenue during the quarter was comprised of $56.8 million of temporary contract revenue and $2.9 million of permanent placement revenue compared to $41.3 million and $0.8 million of temporary and permanent placement revenue in Q2 2017 respectively.

Gross profit for the second quarter of 2018 was $11.9 million, an increase of $4 million or almost 50% over the prior year and up 2.6% sequentially which resulted in a gross margin of 19.9% versus 18.8% in the prior year. Contract gross margin improved by the addition of *first*PRO coupled with $2.8 million permanent placement revenue. It's also worth noting that the prior year gross profit included approximately $0.5 million higher workers compensation insurance benefit than the current year.

Operating expenses for the second quarter were $11.7 million, an increase of 63.1% over $7.2 million for the second quarter of 2017. Of that increase 52.7% can be attributed to the acquisition of CBSbutler, *first*PRO and Clement May and the remaining increase is primarily stemming from other non-recurring costs and other costs associated with acquisitions, capital raising and non-cash charges or credits. This was partially offset by savings that are materializing which are achieved by synergies in the subsidiaries, cost saving initiatives and the PeopleServe divestiture.

Other expenses for the second quarter were $2.8 million, an increase of almost 92% from the $1.2 million in the second quarter of 2017. The increase is comprised principally of higher interest of $1.4 million from the financing of the acquisition of CBSbutler and *first*PRO, a non-cash loss of $0.7 million from re-measuring the company's inter-company note, $0.7 million lower amortization of debt discount and deferred financing costs also attributable to the refinancing, partially offset by a gain of $0.2 million from the sale of PeopleServe and a higher gain of less than $1 million from fair valuing warrants.

This performance translated into income from operations of $0.1 million and a net loss of $1.8 million compared to income from operations at $0.7 million and a net loss of $0.4 million in the prior year. However, adding back the non-cash adjustments and non-recurring cash costs, adjusted EBITDA grew to $2.1 million from $1.5 million in the prior second quarter, a 39.3% improvement. Including all acquisitions consummated during the trailing 12 months on a pro forma basis, our trailing 12-month adjusted EBITDA is now $10.8 million.

On a year-to-date basis revenue increased 39.5% to $115.5 million as compared to $82.8 million for the six months in the prior year. Of that growth $38 million was from the acquisition of CBSbutler, *first*PRO and Clement May and $1.2 million was from favorable foreign currency translation. This is partially offset by a decline of $2 million attributable to PeopleServe and an organic decline of $4.5 million for the remaining core business, the majority of which occurred during the first quarter.

During the first six months, revenue comprised of $109.8 million of temporary contract revenue and $5.7 million of permanent placement revenue compared with $81.3 million and $1.6 million for the prior year period, respectively.

Gross profit for the six months ended June 2018 was $23.5 million, an increase of 53.9% over 15.3 million for the prior year representing gross margin of 20.3% and 18.4% for each period respectively. Gross profit growth and gross margin improvement is attributable to the impact of the prior acquisitions partially offset by lower savings from workers compensation insurance versus the savings realized in the corresponding period in 2017, hire permanent placement revenue and the divesture of non-strategic PeopleServe business.

Operating expenses for the first six months of $23.7 million increased 57.3% over $15.1 million for the prior year period. Of that increase 50% can be attributed to the acquisition of CBSbutler, *first*PRO, Clement May and the remaining increase is primarily stemming from other non-recurring costs and other costs associated with acquisitions, capital raising and non-cash charges or credits.

This is partly offset by savings that are materializing in the subsidiaries and cost savings and its PeopleServe divesture. Other expenses of $2.9 million increased 20.2% from $3.7 million. Although interest expense increased $2.8 million from financing of the two acquisitions in 2017, amortization of debt discount and deferred financing costs decreased by $1.2 million, the prior year includes a loss of extinguishment of debt of $1.4 million and the current year includes a higher gain of $0.7 million from fair value in our warrants as well as a gain of $0.2 million from the sale of PeopleServe.

Turning now to the balance sheet. In June of 2018, we completed the acquisition of Clement May and completed a divesture of PeopleServe. In connection with the Clement May acquisition, we financed the upfront portion with £1.6 million term loan from HSBC at a rate of 2.35% over the base rate of 0.5% or 2.85% interest all in while simultaneously increasing our U.K. factoring facility to £20 million and the secured borrowing against our unbilled receivable to £1.5 million. The term loan with HSBC amortizes monthly over three years.

Additionally, we amended the company's warrant agreement with Jackson Investment Group to remove redundant anti-dilution provisions. This had the accounting impact of a final mark-to-market adjustment of $0.3 million and re-classing the residual liability of $0.5 million to equity.

Finally, cash flow from operating activities was $13 million versus $2.1 million driven principally by the factoring agreement we secured in the U.K. in February of 2018. Investing cash flows provided $3.5 million, again principally from the U.K. factoring agreement where U.S. GAAP requires that we present the collection of deferred purchase price as an investing activity. In addition, $2 million is from the sale of the PeopleServe, partially offset by the cash outflow from the acquisition of Clement May. Of the proceeds we received from the PeopleServe divesture approximately $0.5 million was remitted back to the buyer in July in connection with a networking capital true-up. Cash used in financing activities was $16.7 million driven principally from the pay down of the U.K. borrowing facilities, we entered into with the factoring agreement.

That's the end of my financial review. At this point, operator, let's open the call for questions.

Question-and-Answer Session

Operator
Thank you. [Operator Instructions] Our first question comes from the line of [indiscernible] Partners. Please proceed with your question.

Bill Relyea, Midtown Partners
Good morning. Could you please discuss Clement May and the new business, the RPO business there in, which seems to be have differences in terms of professional staffing. Maybe the type of people that are needed for that and some differences in branding and so on from what you're doing in other professional staffing?

Brendan Flood
Okay. Thanks Bill. This is Brendan. So the principal difference between the RPO model and our normal staff augmentation model is that the RPO model is managed on site, it’s high volume and lower margin, but the volume of contractors or temporary workers that we place more than offsets the reduction in the underlying margin with its reduced execution costs, which we've been discussing over the last couple of calls in relation to lower margin

business. So the conversion of gross profit to EBITDA is as high if not higher than some of our other brands. What has it allowed us to do? The Clement May business 100% professional staffing and it has until now been exclusively IT. Because we've brought it into the fold and because we have CBSbutler in the U.K. placing engineering staff and Longbridge in the UK placing accounting and finance staff, the ability to open those offerings to Clement May's principal clients has been pretty impressive for us so far, so we are already placing accountants with their major clients; we're already placing engineers with their major clients. It's still early days but we believe that the knock on opportunities that we have amongst our other brands could be fairly substantial. We believe that our ability to bring that offering out of the U.K. and into the United States and particularly into our North Carolina geography is also pretty impressive. But, we've got a lot of work to do to make that happen. I think we're going to see some developments on that over the course of the next two quarters or so.

Bill Relyea, Midtown Partners
Thank you. I was going to ask you about taking it down to the lower -- the Southeastern states there where you seem to be doing a great job.

Brendan Flood
Thank you. So hopefully I answered that without you having to ask it.

Bill Relyea, Midtown Partners
Thank you.

Brendan Flood
Thanks Bill.

Operator
Our next question comes from the line of Zach Starr a Private Investor. Please proceed with your question.

Zach Starr
Hi. Good morning gentlemen. I think you guys have done a great job in the top-line sales. And I'm just wondering from an investors' point of view, when are you guys going to or are you planning on acquiring more companies. And when is it going to shift to more of just working out the bottom-line and working on the margin instead of just working on growing the top-line sales?

Brendan Flood
Okay. Thanks Zach. So this is Brendan, again. Our stated aim is to get to $500 million of revenue. And right now, we're at a run rate of about $300 million. So growing organically would take too many years to go from $300 million to $500 million. So we absolutely do intend to continue with our acquisition program in the five strategic pillars that we frequently outline of accounting and finance, IT, engineering, administration and light industrial. But one of the parts that I covered off in terms of the commentary is that we've spent quite a bit of time in the current year working on integration issues. We'll continue to do that.

We have started to take out and we'll continue to take out somewhere in the order of $3 million to $4 million of excess overheads. The appointment of the various Presidents and also Alicia coming in as the Chief Operating Officer allows us to look at some of the larger ticket items like medical coverage costs, which ends up being a multi-year saving, but it takes a while. We are absolutely spending significantly more time in driving towards the bottom-line than we probably have in the past.

Right now, in addition to what I just said about Clement May providing business to CBSbutler and to Longbridge in the U.K. We also have Monroe Staffing in North America providing work to Clement May. We have *first*PRO in Atlanta providing work to Lighthouse Placement Services. We have CBSbutler providing work to The JM Group. So there is significantly more of our intra group activity going on than has ever gone on before.

I don't want to say that the next quarter is ‘the’ quarter, but we do expect that with the continued momentum that we have and having Clement May around for an entire quarter that we will see record revenues again. We will see record gross profit again and if we continue the endeavors that we've been doing on our overhead base then we are pretty clear that our breakthrough in net income is not very far away.

Zach Starr
Keep up the great work.

Brendan Flood
Thanks Zach.

Operator
Our next question comes from the line of Tucker Andersen from Above All Advisors. Please proceed with your question.

Tucker Andersen
Good morning. I have a question and a follow-up. Could you talk a little bit about more the timeline for how you see the $3 million to $4 million cost savings working through your income statement?

David Faiman
This is Dave Faiman. So, I will speak to that a little bit. Some of those things we've already executed during this quarter, other things we've identified scoping and we will execute over this quarter or possibly into early Q4.

I would expect the majority of those savings though to start being realized during the next 12 months.

Tucker Andersen
And Dave, were there upfront costs associated with those savings that are still to be expensed?

David Faiman
There will be a little bit. We're not making heavy investments as a lot of this stems from the fact that we have now gotten, as Brendan said, to scale and we have an opportunity now to start bringing some processes together, centralizing things, making them more streamlined. So it's going to be more taking costs out than major heavy investment upfront.

Tucker Andersen
And then, if I could just ask him the follow-up area, could you talk about, how you get to cash flow breakeven, what you think your burn rate is going to be and the need for financing for future acquisitions. Do you see a need for financing and how you get to that cash flow breakeven?

David Faiman
So our corporate burn rate is about $4 million a year. In terms of financing -- for additional financing for the company, right now we continue to pay all our bills as they become due. The company is generating positive EBITDA, and we're paying our debt service as it comes due. So we're not expecting to need additional -- major additional financing outside of an acquisition.

Operator
[Operator Instructions] Our next question comes from the line of Matt Salazar from Wells Fargo. Please proceed with your question.

Matt Salazar
Hi, guys. I just want to again continue to hammer on this increase in operating expenses relative to the increasing gross profit. I mean the increase in operating expenses is larger than the increase in gross profit. So I'm trying to come around to the idea that these acquisitions are ending up to be accretive.
And then, I guess following up on the previous question, I mean you talked about financing activities. I see you guys as having used up about $2.5 million, I think its $3 million ATM at the market facility that you guys have been issuing out into the market. Maybe you could go a little bit into that as well. Thanks.

David Faiman
So I can speak a little bit to the OpEx to gross profit. So couple of things. First of all, the acquisitions are definitely accretive. The operating expenses that you see during the quarter, whenever we do an acquisition, there always be an increase of sort of what we'll call one-time cost and non-recurring cost associated with the consummation of those acquisitions. Accounting doesn't allow us to capitalize those anymore, so we always do get a blip with that coupled with the operating expense cost take-outs that we've mentioned earlier of the $3 million to $4 million annualized now will provide us an opportunity where you can see more of that gross profit flowing through to the bottom line.

The financing activities of $2.5 million of the $3 million ATM, that's correct, $2.4 million, $2.5 million. We use that opportunistically. So it's -- there's no necessary plan to go out and just use up the remaining $0.5 million, it'll depend on the company stock price and whether there is an opportunity to use it.

Matt Salazar
All right. Thanks guys.

Operator
[Operator Instructions] There are no further questions at this time. And I would like to turn the call back to management for closing remarks.

Brendan Flood
Okay. Thank you, again, Dana. So just as a reminder, we will continue to drive our operational improvements across the group. We will work on expanding our message across the capital markets. We will look for additional opportunities for growth both by acquisition and organically. As I mentioned at the end of all of these calls, as a management team we 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 in November when we report our third quarter results. Operator that is the end of the call.

Operator
This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.