Transcript of the
Staffing 360 Solutions, Inc. (Ticker: STAF)
Fiscal Q3 2015 Earnings Conference Call
April 16, 2015

Participants

Brendan Flood – Executive Chairman, Staffing 360 Solutions
Matt Briand – President and CEO, Staffing 360 Solutions
Jeff Mitchell – Chief Financial Officer, Staffing 360 Solutions
Darren Minton – Executive Vice President, Staffing 360 Solutions

Presentation

Operator
Greetings, ladies and gentlemen, and welcome to the Staffing 360 Solutions Fiscal Third Quarter 2015 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. It is now my pleasure to introduce Darren Minton, Executive Vice President of Staffing 360 Solutions. Thank you, Mr. Minton. You may begin.

Darren Minton – Executive Vice President
Thank you, Brenda, and thank you to everyone today who has joined us for Staffing 360's earnings conference call. I'm joined here by Brendan Flood, Staffing 360's Executive Chairman; Matt Briand, our President and CEO; and Jeff Mitchell, our Chief Financial Officer.

The purpose of this call today is to discuss the financials for the fiscal third quarter ended February 28, 2015, as well as provide an update regarding Staffing 360's high growth initiatives as part of our selective M&A strategy. At the conclusion of this call, we'll be answering questions during a brief Q&A session.

I also 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 this morning's press release and is also 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 conference call. This conference call will contain forward-looking statements within the meaning of the US federal securities laws concerning Staffing 360 Solutions, Inc. Forward-looking statements are subject to a number of significant risks and uncertainties, and 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, April 16, 2015, and Staffing 360 expressly disclaims any obligation to revise or update any forward-looking statement after the date of this conference call.

Now, with that, I'd like to start the call with a few words from Staffing 360s Executive Chairman, Brendan Flood. Brendan?

<u>Brendan Flood – Executive Chairman</u>
Thank you, Darren, and good morning to everybody listening in the United States, and good afternoon to everybody in the United Kingdom. As usual, I will make some opening remarks before handing over to Jeff for some color on the numbers and to Matt for an update on our operations before coming back and adding some more comments prior to the Q&A session.

Since our inception as a business, we have made no secret of our strategic plan. We are a high growth, buy-and-build staffing company. Over the past two years, we have grown from an annualized revenue base of zero to $130 million and delivered on the first phase of our growth plan. During our two most recent quarters, we have executed on what we call our Pathway to Profitability. This pathway was–and is–designed to get the company prepared for the second phase of this growth which will take us to $300 million in annualized revenues while also improving the returns on the businesses that we have already acquired.

Up to this point, this program has been even more successful than we dared hoped for, and it continues to deliver, as you will hear from Jeff. Naturally, we are very pleased with our revenue and gross profit growth rates, our delivery of another profitable quarter in what is seasonally our worst time of the year, allied to the continuing strengthening of our balance sheet and operating cash flows. I trust that what you hear on this call will provide you with confidence that the direction in which we are traveling is a very positive one and that the company continues to go from strength to strength.

At this point I will hand over to Jeff for some more detail on our results. Jeff?

<u>Jeff Mitchell – Chief Financial Officer</u>
Good morning, everyone. It always amazes me the effort that it takes to crank out these SEC filings, so I'm always relieved to report another timely filing. That said, it's even better to follow up the filings with calls like these where we can share some of the progress and some of the highlights with people such as yourselves.

To that end, I thought I might shake things up a little bit from the traditional format we have followed on these calls to date of just regurgitating the numbers, and throwing some percentages in here and there. You all are smart people with access to the filings and press releases that contain all of these numbers, so what I would like to do today is to help you understand the financial performance history since May 31st and what the significant impact the Pathway to Profitability will have on our financial performance going forward.

Let's start with the balance sheet. The obvious highlights here are simple. Total liabilities have decreased by $3.9 million. This has been accomplished primarily through the restructuring plan, and we'll discuss that a little bit later, but also through the liabilities being paid down using operating cash flow. Let's not overlook the fact that during this time, stockholders equity has increased in value by more than $1.4 million. Both of these are major improvements for the company.

Just one more thing on the balance sheet before we move on. As you may have recently read in last week's 8-K filing, we just closed a $3 million four-year term loan with MidCap Financial. The proceeds were used primarily to corral the vast majority of our short-term and on-demand financings, pay them off, and replace them with a more strategic term loan that provides the company with a more stable balance sheet going forward. We look at this as a major upgrade for the company.

Moving to the income statement, there are a number of items here that I would like to bring to your attention that may not have jumped off the page at you previously. For companies that have a buy-and-build strategy, revenue growth is one of those things that is always very difficult to get your head around. You might ask yourself, “How much of the revenue has been purchased? How much of their growth is organic? Or even, how much attrition are they experiencing on their acquired revenue?”

We decided to provide public visibility directly to the answer to these questions. This is found at the bottom of Footnote #14 in our most recently filed 10-Q, and what you will find when you look at this disclosure is the company-wide organic growth rate for Q3 2015 is 17% year-over-year on a pro forma basis. This is certainly outpacing industry averages by more than 10%. When one takes into consideration that this was achieved during one of the worst winters on record in the Northeast where the vast majority of our business is located, this growth is staggering.

The only thing more amazing than our Q3 organic growth is our year-to-date organic growth of 19%. As you may recall from our previous earnings call on January 21st, the company guided revenue of $30 million to $31 million. This revenue guidance included Cyber 360, which has now been removed from our reporting figures since it was sold on February 27th of this year. With Cyber 360’s forecasted revenue of over $800,000, the company would have greatly exceeded the revenue guidance provided.

Moving to operating expenses, operating expenses are certainly not the most sexy thing to talk about on a call like this; however, anyone that understands the staffing industry certainly knows that this is one of the more critical components of building a successful, profitable, and scalable staffing business. The point I want to make here is simple: The Q3 2015 operating expenses as a percent of revenue have decreased from 26.6% to 20.9%, which is pretty remarkable given the fact that revenue has grown from $15.8 million to $31 million. This, my friends, is the keystone to building and growing a profitable staffing business, economies of scale.

Moving on to Adjusted EBITDA, in our most recent press release we provided the non-GAAP calculation of Adjusted EBITDA. We were positive last quarter and are even more pleased to report positive Adjusted EBITDA again this quarter, which is again seasonally and historically the worst quarter of the year for the entire staffing industry and even more so for those of us with geographic concentration in the Northeast.

With the few minutes that I have remaining, I really want to impress upon you the depth and lasting impact of our restructuring plan which was driven by the Pathway to Profitability. Oftentimes, restructuring plans are costly to implement and may not show immediate financial results for quarters or sometimes even years. Our restructuring plan has cost us exactly $441,000 of cash. More importantly, I’d like to share with you exactly what you as shareholders and investors are getting in return for this investment.

Notes payable have reduced by $2.994 million. Cash flow savings in 2015 alone will be $871,000. In 2016, it’ll be $2.3 million. Bonds have reduced by $3.7 million. Cash flow savings to the company on this has been $3.7 million in calendar year 2014. Earn-outs have reduced by $1.1 million. The cash flow savings over the next two-and-a-half years again is that same $1.1 million.

Through consulting and employment agreements, cash flow savings have been $382,000 for 2015 and will be $624,000 in 2016. In summary, the debt has been reduced by nearly $8 million. Cash flow savings over this year and the coming years totals $9 million.

Are we happy with our progress? Yes, of course, we are. It hasn’t been easy, yet we realize that we are not done yet. There is no time to celebrate. We will stay the course and squeeze even more from the Pathway to Profitability before we are done.

You may be asking yourselves, “Where do we go from here?” With our recently announced MidCap financing of a $25 million of revolving credit facility now in place, capital raising is now our primary focus and key to our future growth and success. Currently, we are concentrating our efforts on closing an additional term loan which will be followed shortly thereafter by an equity raise and finally, a large mezzanine financing to execute our M&A pipeline.

In conclusion, we hope that this provides you with the insight into our vision, efforts, and progress. We're looking forward to spring as it always fuels revenue and cash flows. We are going to stay the course and execute our plan.

With that said, I'm going to pass the baton over to Matt, our CEO and President, for a few additional comments.

Matt Briand – President and Chief Executive Officer
Thank you, Jeff, and good morning, everyone. Now that the financials have been discussed, I will be focusing on some of the highlights of the quarter and recent developments as we continue to implement our acquisition strategy. Monroe Staffing, our largest brand with over 15 offices across the East Coast and five on-site locations, grew revenue by more than 15% in the 12 months post-acquisition.

Longbridge, our UK-based operation, has benefitted from the newly combined offices in London after the Poolia acquisition. The group is now showing increasing revenue and operating profit.

In addition, PeopleSERVE, our IT services division in the Boston area, continues its stellar growth. It has experienced over 20% revenue growth post-acquisition. Needless to say, this is a major success for our organization. To take advantage of potential synergies, we have been working with our subsidiary management teams and encouraging them to collaborate with one another. This has already resulted in increased cross-selling and other untapped sales opportunities.

To provide a quick update on our M&A activity, we are focusing on acquiring larger organizations with a keen eye on profitability and management as we position Staffing 360 Solutions for future growth. We are currently at a run rate of approximately $130 million of revenue which includes the full impact of the acquisitions now assimilated, plus the sale of Cyber 360.

Moving forward, we have four acquisitions under letter of intent right now, which would add a further $180 million of annualized revenues. Three of these transactions are in the United States, with one in the United Kingdom. If we completed all of these acquisitions, the revenue split of the business would be approximately $260 million in the United States and $60 million in the UK. Obviously, there can be no certainty that any of these acquisitions will take place until they are finalized, so we have a robust pipeline of acquisitions right behind them.

As previously mentioned, our pipeline represents companies with over $600 million in aggregate revenue. Needless to say, as we move into the next reporting period, we believe Staffing 360 is looking forward to a very bright future as we continue to drive toward our stated goal of $300 million in annualized revenues.

At this point, I would like to hand the call back to Brendan, who will provide some final remarks before we start the Q&A. Brendan?

Brendan Flood – Executive Chairman
Thank you, Matt. Q3 2015 has been a very good quarter for Staffing 360 Solutions, and there is a long list of milestones that have been reached. Our fiscal Q3 revenue has almost doubled to $31 million year-over-year. Likewise, our gross profit has nearly doubled to $5.5 million. Our underlying operations are showing over 17% organic growth year-over-year. We achieved Adjusted EBITDA profitability for the second quarter in a row and are positive on a year-to-date basis. In addition, we achieved Non-Adjusted EBITDA profitability for the first time. This is a major achievement for us and is happening several quarters ahead of schedule.

As you heard from Jeff, we reduced our debt materially and increased our shareholders equity base. Our net loss improved to $81,000, compared to a loss of $1.8 million in the previous year. Finally, we weathered, quite literally, the seasonally weak winter months, and our operations still delivered a very strong result for which I applaud all of our employees.

In summary, our business plan is working, and our Pathway to Profitability is delivering. Brenda, I would now like to open the call to Q&A, please.

Operator
Certainly. (Operator instructions.) Our first question comes from the line of Bill Sutherland with Emerging Growth Equities. Please go ahead with your questions.

Bill Sutherland – Emerging Growth Equities
Thanks very much. You all are currently weighted towards the light industrial sectors and mostly through Monroe. I'm just curious as you look at the plan, both the LOI and the pipeline, what kind of mix can we expect going forward for the business? I know you've talked about the five areas you want to be in.

Brendan Flood – Executive Chairman
Okay. Well, this is Brendan. Maybe I'll start, and Matt, you can pitch in if you'd like to add something to it. The first thing, I'd slightly correct what you said is that light industrial is probably about 50% of our $130 million. The other 50% is spread across professional staffing of IT, engineering, administration, and accounting and finance.

The balance going forward, the entire industry is biased toward IT and light industrial, so I think they will always be the largest two parts. The ongoing balance will really be driven by the timing and order in which we'll do our acquisitions. We would expect that by the time we get to $300 million or more than that, we're probably in the region of 70% professional and 30% light industrial.

Bill Sutherland – Emerging Growth Equities
Okay.

Matt Briand – President and Chief Executive Officer
Brendan, just to tag onto that, the four potential acquisitions under LOI are weighted just the same. About 70% of that is weighted towards professional services, versus 30% on the light industrial.

Bill Sutherland – Emerging Growth Equities
Okay. That's helpful. Jeff, with the new expanded credit line that's collateralized by ARs, I assume this is going to take care of the AR financing you used to rely on in the past.

Jeff Mitchell – Chief Financial Officer
Yes. The new financing is a replacement of the facility that we were using, the largest facility that we were using in the United States, which was through Wells Fargo, and that facility has been retired with this new facility. That is correct.

Bill Sutherland – Emerging Growth Equities
The benefit—I'm trying to kind of put this all, kind of just wrap this all up in a way that I can think about the overall cost of capital going forward. I know you've improved it quite a bit. Can you—is there a way to summarize it for us as far as our models?

Jeff Mitchell – Chief Financial Officer
I can give you a quick summary of the terms of the facility that we just put in place. So, we went from an AR facility with Wells Fargo that was at LIBOR 5 to a facility that is now LIBOR 4. The new facility has more favorable qualifications for the ineligibles for us, so it gave us additional access to borrowing against accounts that were not available to us before. In that sense, the facility is certainly better for the company.

Then with the $3 million term loan that has been put in place we were able to replace the majority of the short-term or on-demand notes that were sitting on our balance sheet, which you can certainly read exhaustively about in our 10-Q if you'd like.

Then over in the UK, we have a facility that services the accounts receivables there with ABN AMRO. We have a small facility with Sterling Bank that continues to fund the CSI business, which is in the cost of more like an 8% or 9% facility, but it's a very small facility.

Bill Sutherland – Emerging Growth Equities

Great. I appreciate all that detail. The last one I wanted to ask you, Jeff, was on all the cleanup or the elimination of consulting professional fee expenses. Will it be a bit more in this last quarter and then essentially zero out that line going forward from this year?

Jeff Mitchell – Chief Financial Officer
With regards to the professional fees, the only items that we should see going forward on those have already been disclosed. We have one consulting contract that will run through the balance of this year that has a remaining amount owed of about $250,000, and then we have some legal fees that we think will continue to push through as we resolve the CSI matter. The other items that you should see flowing through there should be related to very successful financings and acquisitions that we hope to be announcing in the very near future.

Bill Sutherland – Emerging Growth Equities
Right. Of course. Okay. Thank you all.

Brendan Flood – Executive Chairman
Thank you.

Operator
Our next question comes from the line of Douglas Gass with Flow Capital. Please go ahead with your questions.

Douglas Gass – Flow Capital
Yes, good morning. Congratulations on your new credit facility. That sounds like that's going to cut down the cost of capital quite a bit. My question is pretty simple. Are you going to be using any of that capital for your acquisition strategy or is it just for internal use?

Brendan Flood – Executive Chairman
Jeff, you want to keep going while you're on a roll?

Jeff Mitchell – Chief Financial Officer
Sure. So, the purpose of this most recent financing was to complete the cleanup of the balance sheet or get very close to it, which we are happy to announce that we have done. We have a couple of other small pieces that will be maturing over the next coming weeks and/or months. We look forward to taking care of those.

So, the financing that we just closed will not be used towards any of the acquisitions. We are hopeful that the next round of financing is going to be key to closing on the acquisitions. Depending on how that small term loan comes in and the subsequent equity raise and then the mezzanine, we expect that those acquisitions will line up in order and hopefully be closed within the coming quarter.

Douglas Gass – Flow Capital
Okay. Terrific. That answers my question. Thank you very much.

Operator
Our next question comes from the line of Dan Trang with Stonegate. Please go ahead with your question.

Dan Trang – Stonegate
Hello, guys. Thank you for taking my question. I just wanted to get a little bit of color on what you guys are looking at regarding acquisition candidates and kind of what is the timeframe for you guys to complete an acquisition and to integrate it fully into your platform?

Brendan Flood – Executive Chairman
This is Brendan. Let me start on that as well, and then whoever wants to jump in can jump in. It's a very controlled process that we go through on our acquisitions, so we have various rules internally that we must follow. Firstly, any acquisition target must fit one of our five strategic pillars, so it's got to be in IT,

accounting and finance, administration, engineering, or light industrial. If it's outside of those areas, we won't look at it.

It can't be broken. We don't have the time to fix it. We've got a tough enough schedule ahead of us that we want companies that are well-managed, with a good management team that will come with the program and that will stay with the program. They have got to be accretive to our shareholders, which historically has not been that difficult given that we've been generating losses, but on a pro forma growth basis going forward, it's got to be accretive.

It's got to end up being a good financial deal, both for the company and for the sellers. So long as we can meet all of those rules and the people we're acquiring are people who we actually want to work with, then we will move forward. We have four acquisitions that Matt mentioned which are under LOI, so those businesses would close as quickly as we can raise the funding to close them.

In terms of integration, we are relatively "integration-lite." We'll integrate the management team so that it works under Matt. We'll integrate the financial reporting so it flows through Jeff. We'll integrate some of the branding so that it's got familial branding around it. We'll put the 360 globe, and we'll put a strap line of "A division of Staffing 360 Solutions" underneath it. But in terms of huge integration programs, you know, what we want to do is to buy companies that are successful and continue to allow them to be successful, rather than create noise that reduces that success.

So, that's kind of a long answer to a relatively short question, but hopefully that gives you a flavor for it.

Dan Trang – Stonegate
Thank you.

Jeff Mitchell – Chief Financial Officer
This is Jeff. I just want to add one thing to that. Those are all great statements, and I would also add that there's a lot of risk associated with acquisitions: "Are you going to have attrition on your revenue? Are you going to have people falling out?" With our integration-lite approach, I would just like to reiterate that we have found kind of a secret sauce, if you will—not so secret now that we're talking about it in public—that this integration-lite approach has worked very well for us.

We have not experienced any attrition, and the risk of integration has been very low in the fact that we're buying profitable businesses and we're not asking them to change their operations. We're encouraging them to just do more of what they've done in the past, and we try to release some of the operational burden off of them and allow them to spread their wings and fly and grow their revenue. To date, that has proven very successful with all of the acquisitions that we've closed in 2014 and beyond.

Matt Briand – President and Chief Executive Officer
The organic growth rates that we were speaking of before is proof of the secret sauce, if you will.

Darren Minton – Executive Vice President
Dan, just to add a little bit of color on timing as well, I think we mentioned this on our last conference call, but just to reiterate it for those parties that are new, at least one of the acquisitions of the four that we're looking at is not only under LOI, but full due diligence has been done, legal paperwork is done. Literally, as soon as we get financing, that acquisition could be finalized very quickly—within a week or so.

Dan Trang – Stonegate
Thank you.

Brendan Flood – Executive Chairman
Dan, just to close that up—this is Brendan again—I guess you can hear the passion that we have for our M&A program because it's pretty rare on an investor call that every single person wants to pitch in as part of the answer.

Dan Trang – Stonegate
Yes.

Brendan Flood – Executive Chairman
It's incredibly important to us.

Dan Trang – Stonegate
Okay.

Operator
Thank you. (Operator instructions.) Our next question comes from the line of Adam Cichetti with Alexander Capital. Please go ahead with your questions.

Adam Cichetti – Alexander Capital
Great. Hello, everybody. Thanks for hopping on the phone. I was wondering if you could just talk about the multiples that you're paying for these acquisitions and how it relates to some of the public comps that are out there.

Brendan Flood – Executive Chairman
Okay, so what we're looking at Adam, and firstly, as you come from Alexander Capital, I'd like to thank you and the rest of your team for everything you did in raising our capital last week. We look at a multiple of four to six times Adjusted EBITDA. The relative four-to-six really depends upon whether it's a high margin specialist staffing company versus maybe a low margin and light industrial business. The comparable that we look at is the major public staffing companies that have a market cap in the 12 to 14 times Adjusted EBITDA range. The operating leverage of moving from private to public is pretty material for us.

Adam Cichetti – Alexander Capital
Great. Okay. Thank you. Then also, just a quick question about your customer base. What percent of sales does your largest customer make up right now?

Matt Briand – President and Chief Executive Officer
Hello, this is Matt. That's less than 5%.

Adam Cichetti – Alexander Capital
Okay, thank you. That's really all I have guys.

Brendan Flood – Executive Chairman
Thanks Adam.

Operator
Thank you. It seems that we have no further questions at this time. I'd like to turn the floor back to management for any closing remarks.

Brendan Flood – Executive Chairman
Okay, thank you, Brenda. And thank you all for taking the time to join us today. I hope that what you've heard about our latest quarter and our latest activity will assure you that Staffing 360 Solutions represents a tremendous opportunity for rapid growth, both in the United States and in the United Kingdom. As we move forward and continue to implement our strategic gains, we remain committed to growth in revenues, growth in profit, and growth in shareholder value.

Operator, that's the end of our call. Thank you all again, and have a nice day.