Transcript of
Staffing 360 Solutions, Inc.
Fiscal Fourth Quarter and Year-End 2018 Financial Results Conference Call
March 21, 2019

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

Analysts
Ashok Kumar - ThinkEquity
William Gregozeski - Greenridge Global
K. Tucker Andersen - Above All Advisors, LLC

Presentation

Operator
Greetings, ladies and gentlemen, and welcome to the Staffing 360 Solutions Fiscal Fourth Quarter and Year-End 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.

This conference call will contain forward-looking statements within the meaning of the U.S. Federal Securities Law, 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, March 21, 2019, and Staffing 360 Solutions expressly disclaims any obligation to revise or to 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. Where applicable, we have provided reconciliations of 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. Mr. Flood, you may now begin.

Brendan Flood – Chairman & Chief Financial Offer.
Thank you, Operator, and thank you to everyone who has joined us for Staffing 360 Solutions Fiscal Fourth Quarter and Full Year 2018 Earnings Conference Call. I'm joined today by David Faiman, our Chief Financial Officer. I will start my remarks with an overview of our financial and operational fourth quarter and full year 2018 performance. Then I'll hand the call over to David to discuss our financial statements in more detail. After that, I

will give you an update on recent business developments and our strategy going forward before opening the line for questions.

The fourth quarter set a new revenue high for us of $74.1 million, an increase of 24.6% over the prior year. Adjusted EBITDA was flat year-on-year at $2.8 million. However, the prior year had an operational gain of $305,000, principally, for the reduction in doubtful debts. Therefore, on a like-for-like basis, we showed an improvement of 12%. Net income had a loss of $1.4 million, was after noncash charges of $1.4 million. This compares to the fourth quarter of 2017 when the net income loss was $7.3 million, with noncash charges of $5.7 million. Over the course of 2018, our net income loss has improved and if excluding noncash charges, this improvement has been pronounced.

Across the year, we have moved from a $1.1 million loss before noncash items to $600,000 in Q2, $600,000 in Q3 and breakeven in Q4. We would expect this improvement to continue across 2019 at an even more marked rate. For the full year, we had $261 million of revenue, an increase of 35.4% year-on-year with gross profit up 31.5% to $48.3 million. Adjusted EBITDA of $9 million was an increase of 22% on the prior year or 27% excluding the bad debt benefit in 2017. We have continued to talk to possible M&A targets, and we maintain our view that the quality of businesses available in the market is very high.

I'll 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 fourth quarter of 2018, revenue of $74.1 million increased 24.6% over the prior year fourth quarter at $59.5 million and was sequentially up 3.9%. The increase in revenue included $19.8 million from the acquisitions of CBSbutler and *first*PRO that closed in September of 2017, Clement May, which closed in June of 2018, and Key Resources, Inc., which closed in September of 2018.

This was partially offset by a $4.3 million decline attributable to the divestiture of the PeopleServe business in June of 2018, and an organic decline of less than $1 million from the remaining core business. Revenue during the quarter was comprised of $71.9 million of temporary contractor revenue and $2.2 million of permanent placement revenue, compared with $57 million and $2.5 million of temporary and permanent placement revenue in Q4 of 2017, respectively. The temporary contractor revenue in Q4 of 2018 is now $5,531 per week, up from $4,385 per week in the prior year fourth quarter. Additionally, it was up 4.7% from the third quarter of 2018.

We ended with approximately 5,500 temporary contract workers on billing versus 3,900 as of last December of 2017. Gross profit for the fourth quarter of 2018 of $12.3 million increased $400,000, or 3.6%, over the prior year. Gross margin was 16.7% versus 20% in the prior year fourth quarter, partially driven by mix reflecting the addition of the RPO business and Clement May and the acquisition of Key Resources, Inc., which operates in the light industrial space, both with lower gross margins than our professional staffing businesses.

Operating expenses for the quarter were $11 million, or $6.2 million lower versus prior year. Of the decrease, $4.8 million of the decrease was driven by an impairment of the goodwill associated with PeopleServe in Fiscal 2017, which we subsequently divested in June of 2018. The remaining decrease is primarily driven by a prior year restructuring charge of $780,000 in the fourth quarter of 2017 relating to the reorganizing of the Company into its three business streams, coupled with lower noncash and non-recurring items, lower variable costs from the lower organic revenue, and savings attributable to synergies within the subsidiaries. This was partially offset by incremental expenses from the four acquisitions and a prior year credit associated with lower bad debt in the fourth quarter of 2017.

Income from operations in the quarter was a positive $1.3 million, the Company's third consecutive quarter of positive operating income. This was versus an operating loss of $5.4 million in the prior year comparative quarter. Other expenses for the fourth quarter of 2018 was $2.6 million versus $1.2 million in Q4 of 2017. The increase was mainly driven by a gain associated with fair value in our warrants in the fourth quarter of 2017 with no corresponding gain in the fourth quarter of 2018, and a loss from the current year from re-measuring the Company's intercompany note.

Finally, we had an over $600,000 reduction in our provision for income taxes. All of this performance translated into a net loss of $1.4 million, compared to a net loss of $7.3 million in the prior year or a $5.9 million improvement. EBITDA grew to $2 million from a $3.3 million loss in the prior year comparative quarter, marking our fourth consecutive quarter of positive EBITDA and an Adjusted EBITDA of $2.8 million.

For the full year Fiscal 2018 revenue increased by 35.4% to $260.9 million compared with $192.6 million for fiscal 2017. Of that growth, $85.3 million was from the acquisitions of CBSbutler, firstPRO, Clement May and Key Resources, Inc., and $0.3 million, or $300,000 was from the favorable foreign currency translation. This was partially offset by a decline of $10.7 million attributable to the divestiture of PeopleServe and an organic decline of $7 million from the remaining core business, more than half of which occurred during the first quarter.

Fiscal 2018 revenue was comprised of $250.4 million of temporary contractor revenue and $10.5 million of permanent placement revenue, compared with $187.2 million and $5.4 million for the prior year period, respectively. Gross profit for Fiscal 2018 was $48.3 million, an increase of 31.5% over $36.7 million for the prior year, representing a gross margin of 18.5% and 19.1% for each period, respectively. Gross profit growth was attributable to the impact of acquisitions, partially offset by lower savings from workers' compensation insurance versus the savings realized in 2017, organic revenue decline and the divestiture of our lower-margin PeopleServe business.

Operating expenses for Fiscal 2018 was $46.6 million, an increase of 11.2% over $42 million for Fiscal 2017. Of that growth, almost 30% can be attributed to the acquisitions of CBSbutler, *first*PRO, Clement May and Key Resources. Excluding this, underlying operating expenses declined by 18.6%.

As mentioned in the fourth quarter results earlier, the remaining decrease was driven by PeopleServe's impairment in 2017, the 2017 restructuring charge lower non-recurring costs and noncash charges, lower variable cost and savings and synergies that we realized in 2018. Other expenses of $8.1 million decreased 34.1% from $12.3 million. Although interest expense increased $4.6 million from financing of these acquisitions, amortization of debt discount and deferred financing costs decreased by $2.2 million, also attributable to the refinancing's.

The prior year included a loss on extinguishment of debt of $6.1 million, while the current year includes a higher gain of $0.5 million from the fair value of warrants, a gain of $200,000 from the sale of PeopleServe, other income of $0.5 million from the investment on workers' compensation collateral and a true-up adjustment to the CBSbutler earn out. These were partially offset by a loss of $700,000 from remeasuring the Company's intercompany note.

Fiscal 2018 EBITDA was a positive $5.6 million compared to an EBITDA loss of $7.5 million in the prior year and this represents positive EBITDA for every quarter in the fourth—in 2018. Adding back the noncash adjustments and non-recurring cash costs, Adjusted EBITDA grew to $9 million in 2018 from $7.4 million in 2017.

Turning now to the balance sheet, during the fourth quarter, we completed an exchange of $13 million of term loan into a Series E preferred share. The Series E carries a 12% cash dividend similar to the term loan and a fixed dividend of 5% of the face value. Subsequent to year-end, we raised $4.9 million through equity and settled the *first*PRO deferred consideration of $2.2 million, both of which are not reflected as of December 29, 2018.

Finally, with respect to cash flow, the Company has realized $2 million of positive cash flow from operations versus a cash outflow from operations of over $7 million in Fiscal 2017. That debt to (phone) Series E preferred exchange, I mentioned earlier, had no effect on cash flow.

Now, I'm going to hand the call back to Brendan.

Brendan Flood – Chairman & Chief Financial Offer.

Thank you, Dave. Twenty eighteen was a very busy year for Staffing 360 Solutions. We reorganized into three business streams to allow greater focus on specific product and geographic offerings. We completed two acquisitions, Clement May in the U.K. and Key Resources in the U.S. We divested of the PeopleServe business in U.S. We rebranded all of our offerings and fostered a greater degree of collaboration between our brands. We reorganized our finance function into shared service centers in both geographies with U.S. version continuing to be rolled out. We were positive at a non-Adjusted EBITDA basis in each of the four quarters of the year and operating cash flow positive across the full year. We maintained our NASDAQ compliance and improved the quality of our balance sheet. We declared our first ever dividend on our common stock at $0.01 per share per quarter, the first dividend was paid in February of 2019. More recently, as Dave mentioned, we raised a gross sum of $4.9 million, which continued to strengthen our balance sheet. Part of the use of funds was to pay down an outstanding deferred consideration of $2.2 million on the *first*PRO acquisition with a full and final settlement payment of $1.1 million effectively improving the quality of the raise to $2.05 per share from the $1.65 headline number.

We ended a three-year contract extension with our largest client, British American Tobacco in the U.K. which started in January 2019, and also entered a $10 million to $15 million contract with a large light industrial commercial client in the Northeastern States of the U.S. in January, which is anticipated to be fully staffed by mid-summer.

With all of these activities that have happened, we are at a point in our development where it makes sense to discuss guidance going forward. Excluding the impact of any further acquisitions, for the 2019 fiscal calendar year, we are anticipating that our revenues will be a minimum $320 million, our non-Adjusted EBITDA will be in the $12 million-plus range, and that we will be net income positive for the year as a whole.

Operator, at this point, I would like to hand the call over to Q&A, please.

Question-and-Answer Session

Operator
Certainly. We will now begin the question-and-answer session. To join the question queue you may press star, one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, two. Once again, to ask a question, please press star, one. We will pause for a moment as callers join the queue.

Our first question comes from Ashok Kumar with ThinkEquity. Please go ahead.

Ashok Kumar:
Good morning, Brendan and Dave, thank you for the presentation. Could you please flesh out the improving cash flow dynamics? You highlighted the settlement of *first*PRO obligations at a 50% discount. So that should improve—reduce your upcoming cash obligations. Then, you also talked about the improving operating performance, this low 300s top line revenue number and jumping (phone) millions of dollars, and low single-digit operating margins, and you should be able to generate $8 million to $9 million in operating income on an annualized basis. Thank you.

David Faiman:
Hi, Ashok. This is David Faiman. I'll take the first part on the cash flow and then Brendan will address your question about the operation and projected revenue. So, the *first*PRO settlement, the total amount that was still remaining to be paid was just under $2.2 million. That was going to be coming over the remainder of 2019 and most of 2020. We were at a schedule to pay $75,000 per quarter, the first of each quarter, and a large payment of $892,000 in September of each year. So, that's about $1.2 million cash savings this year with the residual being about $1 million next year of cash that won't be going out of the business.

In terms of operating cash flow, the positive operating cash flow that I spoke to earlier versus the $7 million negative in the prior year speaks to the Company's continued growth, the scale that we're getting, the savings we're realizing and as we continue to get closer and closer to that overall net income and certainly cash positive generation.

Brendan Flood
So, Ashok, hi, this is Brendan. Yes—go ahead.

Ashok Kumar
No, there were some comments on this back renewal, right, because that's a significant, I think, accomplishment to extent that engagement to the multi-year extension for RPO and staffing services.

Brendan Flood
You're absolutely right, and this came with our Clement May acquisition in London, an acquisition we're incredibly happy with, and Chris Rowbotham and his team have done a phenomenal job in negotiating that extension with British American Tobacco, but what is also a great achievement in that particular brand is that British American Tobacco with Clement May has historically been an IT recruitment client.

Since we acquired Clement May in June of 2018, we've had the opportunity to provide engineers from our CBSbutler brand and accountants from our Longbridge brand. So therefore, the amount of revenue that we generate from that client has gone up fairly significantly. More recently, they have also provided us with an opportunity to hire 400 members of staff for their operation in Kuala Lumpur. We're also looking at some of their other international operations to provide further support. So, it's been a phenomenal achievement for Chris and his team, and we're very happy with it.

Ashok Kumar
All right, and there is an opportunity to obtain a similar contract on the U.S. side, right, in North Carolina, where Monroe (phone) and Key Resources (inaudible).

Brendan Flood
So, we've continued to look at British American Tobacco and its operations wherever they may be. We're exploring all opportunities that we can exploit, for a want of better word (phone), with them. So, for sure they have operations in North Carolina, they also have operations in Mexico, they have operations in Poland and we're in discussions with British American Tobacco about all of those.

Ashok Kumar
Got it, and one last question on dividend, and I got—that's a positive signaling, given that it's going to be roughly inexpensive for you to implement $60,000 per quarter. Given your outlook and continued improvement in Adjusted EBITDA, right, and the potential that we could be exiting the year at this $100 million quarterly revenue run rate?

Brendan Flood
Well, from your lips to God's ears, Ashok, $100 million per quarter would be a wonderful thing. Principally, the message about the dividend, you're absolutely right. It doesn't cost a lot of money. We have about 8 million shares in issue right now, so the next version of that dividend will cost us maybe $80,000. So, it isn't huge. But we wanted to issue a message that the confidence internally in our performance is growing. Our expectation of our performance across 2019 is significantly more robust than 2018.

We incurred a lot of integration costs during 2018 in terms of realigning our business into three business streams, also setting up the shared-service centers with our finance team in particular but also some other support services within that. So, those things are pretty much done. There's a little bit of work still occurring in the United States, but the vast majority of that work is all done. Therefore, we won't be incurring the same level of exceptional cost as we did in 2018.

So, we want to send a message that our ability to generate cash in 2019 was strong, and that was pretty much the message in issuing the dividend that we're feeling significant better in 2019 than we felt in any year in the Company's history.

Ashok Kumar
Thank you, Brendan and David, appreciate it.

Operator
Our next question comes from William Gregozeski with Greenridge Global.

William Gregozeski
Hey, guys. I have got a couple of questions. Your Adjusted EBITDA was flat year-over-year, but your pro forma trailing 12 month Adjusted EBITDA was down $1 million from what it was in the third quarter. Could you talk about why that was?

David Faiman
So, we had some decline in the U.K. portion of the business. We did also add some costs with the addition of Alicia Barker, our Chief Operating Officer, who came in right at the beginning of the—or right at the end of the third quarter. So, those were the contributing factors overall to the sequential decline.

William Gregozeski
Okay, and do you guys have a pro forma trailing 12-month revenue number you can give?

David Faiman
I don't know if I have it right here in front of me. If you want to ask your next question, I can see if I've got that handy in front of me.

William Gregozeski
Okay. How much of the—the money you guys recently raised, how much of that was used to pay back or to Jackson?

David Faiman
None of it.

Brendan Flood
None of it. So, under the agreement with Jackson Investment Group that we're allowed to raise $3 million without making any payment to that fund. Anything above $3 million, he has the right to request us to use it for recovery of his preference shares. But he reached out to us and he's been a phenomenal support for us and said, hey, for the money that you would otherwise give me, do you have a better way of spending it? That's how we moved on to the opportunity with *first*PRO, that it was a significantly better use of $1 million to give $1 million to the sellers of *first*PRO in order to take back $2 million of debt.

So, that is another incidence of the Jackson Investment Group being a great supporter of the organization.

David Faiman
Bill, to answer your question, Bill, the pro forma revenue for 2018 is $308 million.

William Gregozeski
Okay, and then, you talked about you're still engaging in M&A discussions. Are you seeing a lot of interest in reasonable valuations in the market?

Brendan Flood
So, I guess that depends upon your definition of reasonable. It was certainly at a point where the multiples that people are requesting are bit higher now than they were 12 months ago. So, we have to be a little bit more

cautious about what conversations we enter. But we are seeing that there are a lot of businesses out there, quality businesses that are still up for sale and are still interested in being sold.

William Gregozeski
Okay, and last question, will the 10-K be out today?

David Faiman:
Not today. We're working trying to do it by aftermarket tomorrow. We're literally just at the final stretches, last admin, dotting i's, crossing the t's. So, if it's not tomorrow night then it'll be on Monday.

William Gregozeski
All right, great. Thanks guys.

Brendan Flood
So, Bill, we are, just to confirm just in case there's any uncertainty, we don't anticipate that the 10-K is going to say anything different to what you've heard on this call.

William Gregozeski
Okay.

Operator
Our next question comes from Tucker Andersen with Above All Advisors. Please go ahead.

K. Tucker Andersen
Yes, congratulations on the improvement. I have a few questions. The first ones all have to do with revenues. So, I'll sorts of lump them together. First, do you have any thoughts on how the Brexit turmoil might be affecting your U.K. business, if it is?

Second, in the revenue category, what affect has the very tight labor market in the U.S. had on your, both, staffing demands and ability for—to have personnel available you would reference that a little bit on the previous calls? Third, could you talk about the trends and the factors that cause the comparable revenue from continuing operations to be down very slightly?

Brendan Flood
So, the first question is on Brexit. It's one of those wonderful things. I live in the U.K. So, it's kind of like is the first thing that appears on the news every day. In terms of our business, it affects a little bit in terms of the cautiousness or uncertainty, obviously gets into clients' mind and there has been a degree of waiting around to see what's going to happen with it. Even now where Brexit is supposed to happen next Friday, there are still discussions going on in Brussels about whether it gets extended for a month, it gets extended for two months, gets extended for two years or goes away. It's not got a huge impact in terms of revenue and we couldn't point to a number and, say, that's the amount that relates to Brexit. But certainly, the uncertainty that is permeating the U.K. market is unhelpful, and it's helpful for the industry in its entirety. But I can't point to a number, Tucker, and say, that's what Brexit is doing for us.

In terms of the tight labor markets, we've got a tight labor market in both geographies. I did reference it on the last call that we had quite a few conversions of our temporary contractors into permanent employees. But as Dave mentioned that we ended the year with 5,500 contractors out and that number has improved during the course of first quarter of this year. So, it's impacting us.

Even this week, we had a temporary contractor start with our Lighthouse Placement Service business on Monday. By Wednesday, he was converted into a permanent employee. So, it is having an impact, but we **just keep** going. The Atlanta market where our *first*PRO business is for professional staffing people or professional candidates, we pretty much have a zero-unemployment market. So, our recruiters have to work harder in order to find eligible candidates. But, on the positive side, it helps us to maintain margins because clients are pretty desperate for staff and, therefore there's not a lot of negotiation of the rate going forward. Forgive me, Tucker, but I can't remember what the third question was.

K. Tucker Andersen
Yes, just if I heard correctly on a comparable basis, your revenues for continuing operations were down very marginally and I was just wondering what the trend was there? If there were any specific causes, and if part of it was, in fact, the things you've just discussed, sort of, offsets in terms of the tight labor market?

David Faiman
Hi, Tucker, it's Dave. I would say, there's not one thing that some macro factors that we are driving to other than we are seeing more conversions, as Brendan mentioned, in the professional market. Back to the question that Bill had asked about earlier, the sequential decline. Those conversions, we did see a sizable amount in the fourth quarter in our professional U.S. business as well. While we do get sometimes a nominal amount for a conversion depending on how long the temp contractor has been placed with a client, those conversions will provide a little bit of revenue but generally, unfortunately, eat the revenue stream up going forward.

K. Tucker Andersen
Yes, I guess, the advantage of a two-day conversion is you picked the perfect portions for that slot. So, that didn't help you too much. The other area of questions...

David Faiman
Yes. Certainly, yes.

K. Tucker Andersen:
The other area of questions is just ex the impact of any acquisitions, which I know you can't talk about, you can't predict, you're uncertain until they happen. What is your financing—future financing plans either with regard to equity or debt?

David Faiman
So, as we've said in the past, we are very, very picky about our acquisitions. I would say we turn down over 9 out of 10 that we see. Brendan and I, probably between us, get at least six that are passed to us a week. If we get to the point that we are actually negotiating and closing on a deal, oftentimes we will fund the acquisition, a lot of times with the receivables that are on the target's balance sheet. So, I must acquire it with that—the Company's receivables by borrowing against them on the first day. We'll take out a little bit of term debt to cover the remaining upfront portion. Then, there's always some type of deferred consideration, whether it'd be in a form of an earn-out, or like in the case of *firs*tPRO, it was just a payment stream.

But, that's how we have in finance. We're not opposed to using our stock, but not as these prices. We've used stock in the past but at $1.65 or $2 it's just too dilutive to the shareholders.

K. Tucker Andersen
Thanks for the dividend signaling. I thought that was very meaningful, and congratulations.

David Faiman
Thanks Tucker.

Operator
This marks the end of our QA session today. Does anyone on the team have any closing remarks?

Brendan Flood
Sure. Thank you, Operator. So, as we continue to drive improvements through our operational performance, and we continue to expand our story to a greater audience, we will continue to look to our stock price to move to an acceptable and normal level in relation to our industry peers. As a Management team, we remain committed to growth in revenue, to growth in earnings and to growth in shareholder value.

Thank you all, and we look forward to speaking with you again. 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.