Transcript of
Staffing 360 Solutions, Inc.
Fiscal Third Quarter Financial Results Conference Call
November 13, 2019

Participants

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

Analysts

William Gregozeski - Greenridge Global
Jonathan Gruber - Private Investor
Tucker Andersen - Above All Advisors

Presentation

Operator
Greetings, ladies and gentlemen, and welcome to the Staffing 360 Solutions Fiscal Third Quarter 2019 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. 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 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 Solutions' actual results to differ from those contained in our forward-looking statements. All forward-looking statements are made as of today, November 13, 2019, and Staffing 360 Solutions expressly disclaims any obligation to revise or to update any forward-looking statements after this date of this conference call.

During the 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 measurements and most directly comparable GAAP measures.

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
Thank you, Operator, and thank you to everyone who has joined us for Staffing 360's Fiscal Third Quarter 2019 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 performance, covering the third quarter of 2019. Then I'll hand the call over to David Faiman to discuss our financial statements in more detail. After David is finished, I will give you an update on recent business developments and our strategy going forward, before opening the line for questions.

The first quarter delivered a 5.6% decline in revenue, from $71.3 million to $67.3 million. This entire decline was the combined result of a loss of a pay rolling client in the U.K. and $1.5 million of currency translation impact. This pay rolling client operated at a 4.6% gross margin. Therefore, the impact on gross profit and on EBITDA was not significant. As a consequence of these two items, allied to an improved permanent placement performance, our gross profit was flat year-on-year at $12.5 million.

Continued management of SG&A meant that we delivered an Adjusted EBITDA of $2.9 million or a 16.2% growth on the $2.5 million of the previous year. Our net loss for the quarter was $1.1 million, which included negative currency impact of $467,000 on a non-cash basis, and also included the net settlement benefit of the breach of warranty claim of $1.1 million.

Our press release contains a table showing the trailing 12 months performance, and in this regard, our revenue has increased by 17.2%, our gross profit increased by 2.4% and EBITDA has grown to $7.9 million on a non-adjusted basis from a comparative of just $344,000 last year.

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

David Faiman
Thank you, Brendan, and good morning everyone.

For the third quarter of 2019, revenue of $67.3 million declined 5.6% from the prior year of $71.3 million. Revenue in the quarter includes $5.4 million from the acquisition of Key Resources that closed in August of 2018, and unfavorable foreign currency translation of $1.5 million. The remaining decline stems from contractor revenue, primarily due to the loss of below-margin client in the U.K. that Brendan mentioned earlier, offset by a 23.7% growth in our perm placement revenue.

Revenue during the quarter comprised $64 million of temporary contractor revenue and $3.5 million of permanent placement revenue. The temporary contractor revenue is now approximately $5,000 per week, and we ended with approximately 5,000 billing temporary contractors.

Gross profit for the quarter of $12.5 million was flat against the prior-year third quarter, despite the revenue decline, while gross margin of 18.5% improved a hundred basis points from 17.5% in the prior-year quarter, primarily from the increased perm revenue. Operating expenses of $12.2 million were slightly higher than the prior year, primarily driven by the acquisition of Key Resources. Excluding non-recurring and non-cash costs though, underlying operating expenses have declined approximately $700,000. These operating results translated into income from operations of a positive $257,000, being the Company's sixth consecutive quarter of positive operating income.

Below operating income, net other expenses for the quarter were $1.3 million versus $2.6 million in the prior year. Interest expense declined approximately $400,000, and we recognized a net gain on the settlement of the CBS Butler's earn-out, partially offset by the non-cash foreign currency re-measurement loss of $467,000 from the continued weakening of the pound sterling.
This performance translated into a net loss of $1.1 million, improving almost 50% from the prior year's $2 million. On a run rate, EBITDA grew 54% to $1.8 million, making our seventh consecutive quarter of positive EBITDA, and Adjusted EBITDA grew 16.2% to $2.9 million.

On the balance sheet and cash flow, during the quarter, we received $2.5 million in the form of a bridge loan from Jackson Investment Group, which was used to fund the final payment of the CBS Butler earn-out.

I'll turn the call back over to Brendan now.

Brendan Flood

Thank you, Dave. From time to time, we are asked questions about the impact of Brexit on our U.K. business, and I typically respond that it is difficult to quantify, what is the impact of Brexit against, what is the impact of other market conditions.

It is absolutely fair to state that continued uncertainty is not a positive, and we, along with the rest of the industry, look forward to some certainty whatever the outcome. As a possible consequence of Brexit, and the proposed taxation legislation known as IR35, over the course of the past three months, we have had approximately 100 U.K. contractors change their status from temporary contractors to permanent employees, often without a conversion fee, as they've been contracting for a significant period of time.

With that said, I'm pleased to say that we're still experiencing very strong demand for candidates in each of our business streams. As mentioned on our last call, we are working with clients to accentuate the need to shorten the hiring process in order not to lose quality candidates to competitors. We continue to make solid progress on adding new clients, albeit traction is a bit slower than anticipated, but most of that benefit will now fall into 2020, given that we are now moving into the holiday period.

During the second half of the current year, a number of our clients have asked us to accommodate their needs outside of our core markets of the United States and the United Kingdom. Our largest client required assistance in Kuala Lumpur, in Malaysia. Since late May, we have placed 150 permanent employees for them and in partnership with them. As a consequence of this, they have requested our help in Warsaw, in Poland, and they are looking for up to 40 additional employees before the end of the calendar year.

Recently, we gained experience in Poland through our IT brand in the U.K., the JM Group, where we have placed 73 people, another 10 under offer, and with the expectation of a further large number between now and the end of the first quarter of 2020.

In terms of our brands working together, we have had four brands all collaborate on a project in the U.S. that is in development and could add to our journey early in 2020. As I've stated on previous calls, it is always a source of great pleasure and business plan validation to see acquired brands working together to deliver on a client need.

Turning to our ongoing M&A efforts, we have recently engaged R.W. Baird, a multinational independent investment bank and financial services company, to assist us with strategic acquisitions and related financing of our balance sheet to accommodate any successful transactions. As we said in the Q3 results press release, we are making meaningful progress, and I am optimistic, but there can never be certainty of any outcome until a transaction actually closes. I look forward to updating you as events warrant.

Our business view both of the economies and the labor markets in which we operate continues to be very positive. Earlier in the year, we provided guidance that we expected to deliver $320 million of revenue in 2019, and to be net income positive. Our expectation now is that quarter four will look similar to quarter three, excluding the impact of any acquisition activity, and that our full-year revenue number will be between $275 million and $285 million.

Based on the very positive staffing business outlook in the U.S. and the U.K., and the strong labor markets, I remain highly confident about our future. I was, and am, still bullish about our Company and the opportunities before us, that in late June, I purchased 50,000 shares of our common stock in the open market, needless to say, at a higher price than today, but I still consider that to be a good purchase.

Before I turn the call over to the Operator, I'd like to point out that our Q3 quarterly cash dividend of $0.01 per share of common stock was paid to shareholders on September 6.

Thank you for your time to listen to us today. Operator, at this point, I would like to hand the call over to you for the Q&A session.

Question-and-Answer Session

Operator
Thank you. Ladies and gentlemen, we will now be hosting a question-and-answer session. To ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate when your line is in the queue. Please press star, two if you would like to withdraw your question from the queue. For those callers on speakerphone it may be necessary to pick up the handset before pressing the star keys. One moment, please, while we poll for questions.

Take the first question from William Gregozeski from Greenridge Global. Please go ahead.

William Gregozeski:
Hi guys. Can you quantify the annual impact of the large client that was lost?

David Faiman:
Sure, so on a couple of different levels. Firstly, on the revenue level, it was approximately a million pounds per month, so $1.25 million, at a 4.6% margin. Therefore, it was £46,000 of gross profit or $55,000 of gross profit per month.

Excluding some commissions that are payable about that, it probably costs us—it probably hit us about $40,000 per month or $480,000 per annum on EBITDA, and our saving in interest cost because of the manner in which the payroll runs against that, we probably saved ourselves about $250,000. The net loss impact is about $200,000 per annum.

William Gregozeski:
Okay, and was that a Clement May client? If so, is that going to impact the earn-out due to them?

David Faiman:
The earn-out has already been paid, which is the payment that we made in June of 2019. It was a Clement May client. It was not one of their strategic clients because it was just a payroll client. It doesn't impact the largest client in the group who we picked up with the Clement May acquisition.
The payment that is due in December is purely a loan note, deferred consideration.

William Gregozeski:
Okay. Then on the Key Resources earn-out, has any of that been paid?

David Faiman:
Not yet.

William Gregozeski:
Okay. All right, great. Thank you, guys.

Operator:
Thank you. We'll now take the next question from Jonathan Gruber, a private investor. Please go ahead.

Jonathan Gruber:
Good morning. Could you please provide some color on the acquisitions that are in your pipeline, and how many that entails and what the status of that is today?

Brendan Flood:
All I can tell you, Jonathan, is pretty much what was stated in the press release, but I will give some background color about the strategy of the Company.

Firstly, the strategy of the Company is to buy, integrate and build staffing companies between the United States and the United Kingdom. Our stated goal is to get ourselves to $500 million. We're currently—as I said, our guidance is now at $285 million, so we've got to pick up another couple of hundred thousand. There are always a number of acquisitions in our pipeline, therefore we're always talking to a number of people. There are two acquisitions that we are specifically making some progress on that are currently in due diligence.

I'll caveat that with the ongoing over rider that a transaction isn't a transaction until it closes, so therefore we've got a lot of work still to do. But those people who are familiar with R.W. Baird, it's not a small organization. They are a very serious player in the staffing industry, and they are playing very seriously with us right now at the moment. Beyond that, I'm not sure I can add too much to your question, John.

Jonathan Gruber:
That's fine. With facilitating R.W. Baird, what type of annual savings do you expect to get in the future with the restructuring of your current debt level?

David Faiman:
John, I think that's just too premature to even speculate what that could be. We're in early discussions with W. Baird about what the structure of that is. As you might know, there's a million different structures that could come out of that, so I'd be loath to speculate what that could result in.

Jonathan Gruber:
Thank you for your time.

Brendan Flood:
Thank you.

Operator:
We will now take the next question from Tucker Andersen from Above All Advisors. Please go ahead.

Tucker Andersen:
Good morning, Brendan and David. The recalibration of the expectations for the fourth quarter revenues, and importantly, annual revenues, obviously some of that was due to the—because you dropped the non-strategic client. But you also mentioned we're near the holiday season and therefore that's affecting, perhaps, some new business coming on.

My question would be, how does that affect your thoughts about the revenue run rate as we go into next year? Should we view the fact that we're starting at a lower expected level exiting this year as a substantial impact on next year, or your thoughts about next year, pre-acquisitions, sort of unchanged?

David Faiman:
There are a couple of things. Ignoring the pay rolling client in the U.K., because it is what it is. But there's actually a huge, or relatively large cash flow benefit of not having that client in our portfolio. As I said, it's a 4.6% margin, so therefore, by definition it means we're paying 95.4% of our gross profit in payrolling costs. That client paid us on a 90-day basis, but we have to pay everybody on a weekly basis. We can only borrow 90% of those invoices, and there are asset-backed lending facilities, so therefore we're 5.4% out every single week, and we have 13 weeks of payroll that run prior to receiving the cash from the client.

We're probably always out by a couple of hundred thousand a quarter on having that client, from a cash flow perspective. It should be not a material benefit, but a substantial benefit to us across 2020.

In relation to revenues, the other part of why we are where we are is that the number of projects that we were working on during the course of 2019, the traction on them is a little bit slower than we had previously expected. Some of those clients are very large and they don't move as quickly as we would all hope that they would move. In terms of our growth into 2020, it's probably not really changed against what we've previously stated. It's just that the starting point is a bit lower.

I think the opportunities that we have are as great as they've ever been, and the expectation of our performance in 2020 is not materially less than we previously thought it was going to be.

Tucker Andersen:
Thanks, good luck.

David Faiman:
Thank you.

Operator:

That marks the end of our question-and-answer session today. I'd now like to turn the call back over to Brendan Flood for a brief closing comment.

Brendan Flood:
Okay, thank you, Lisa. In closing, we continue to have a positive outlook for the business and for our markets. I extend my thanks and appreciation to our talented and hardworking staff and Management team who are responsible for all of our successes.

As a Management team, we look forward to continuing to drive improvements through our operational performance and continuing to drive and to maintain shareholder value as we progress on our path to build a $500 million profitable revenue Company.

Thank you all, and we look forward to speaking with you again. Operator that is the end of our call.

Operator:
Thank you. Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.