Transcript of Staffing 360 Solutions, Inc.
Fiscal Q12020 Results Conference Call
June 29, 2020

Participants

Brendan Flood - Chairman & Chief Executive Officer
Sharnika Viswakula, Corporate Controller and Principal Accounting Officer
Alicia Barker, Chief Operating Officer

Analysts

William Gregozeski - Greenridge Global
Paul Denby - Denby Enterprises

Presentation

Operator

Greetings, ladies and gentlemen, and welcome to the Staffing 360 Solutions Fiscal Q1 2020 Financial Results 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, June 29, 2020, 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 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 Q1 2020 Financial Results Conference Call.

I'm joined today by Alicia Barker, our Chief Operating Officer; and by Sharnika Viswakula, our Corporate Controller and Principal Accounting Officer.

I will start my remarks by saying, as I did on our last call, that I hope that everyone is staying healthy and safe during this unprecedented COVID-19 pandemic. The well-being of our staffs, contractors, and clients has continued to be our main priority since the virus was discovered and the outbreak spread to our geography.

Sharnika will provide more depth to our financial results, and Alicia will update you about how our business has managed through this environment from a practical perspective, including how we have begun to reopen our offices while ensuring that we continue to provide our customary best-in-class client service. Alicia will also express our views supporting social and racial equality in this time of civil unrest.

I'll begin with an overview of our financial and operational performance covering the first quarter of 2020, then I will hand the call over to Sharnika for further details, after which Alicia will update us on the operational impact of COVID-19 pandemic and our continuing response to it. I will finish by outlining what we are seeing performance-wise in the second quarter, what our near-term plans are in relation to our acquisition strategy, and our intended refinancing of our business. The line will then be opened for questions.

As outlined in our press release on Friday, revenue for Q1 2020 was $58.7 million with gross profit at $10.6 million. Both of these metrics are in line with the numbers previously estimated on the year-end call. The reductions year-on-year were principally driven by the loss of a payrolling account in the U.K, the introduction of the IR35 tax legislation in the U.K., along with the impact in March of the COVID-19 pandemic.

On a sequential basis, our Q1 revenue was down 8% against Q4, with gross profit down 8.6%. Both of these are materially in line with our seasonal movements, and slightly better than the 10% drop that I guided towards in the previous call.

At the end of March and the beginning of April, we took $4.2 million of annualized overhead out of the business and followed this up with a further million dollars of annualized savings during Q2.

Our Adjusted EBITDA for Q1 was $1.2 million, which was down year-on-year and reflects the drop in gross profit in the quarter. Q1 is typically our lowest profitability quarter, and this year it was also impacted by the economic effect of COVID-19.

You will have seen that we took a $3 million goodwill impairment charge in the first quarter against our firstPRO business in Georgia. This is a reflection of the impact of COVID-19. firstPRO has a heavy proportion of permanent placement business within its offering, and this area has been challenged most by remote working, lockdown, and the difficulty in completing face-to-face interviews. The team at firstPRO have worked as diligently as all of our brands, and we believe that the uplift in demand for these services will occur once clients can reopen and re-engage their various projects over the course of the coming quarter.

From a cash management perspective, we saw an improvement of $2.9 million in our cash management in Q1 2020 over Q1 2019. This was primarily driven by cost containment and receivables management, particularly in the U.K. where we moved from having £1.5 million of aged debt down to about £100,000 in the space of three months. While cash management is always key to a business like ours, it gained a heightened degree of focus in the specter of the oncoming COVID-19 concerns. These levels of controls have continued into Q2, and I'd like to compliment the finance teams of both the U.S. and the U.K. for recognizing the need for this laser focus, and also on an excellent job in executing on it.

The key challenges that we faced during Q1 related to the implementation of IR35 in the U.K., which necessitated that we quickly and efficiently re-shaped some of the brands from primarily offering contract placement services to primarily offering permanent placement services. This was a transformation that started in late Q3, early Q4 of 2019, and continues into the current year.

In early March, we faced the advancement of the pandemic and the movement to shelter-in-place and lockdown. We successfully closed all of our offices between March 16 and March 22 and saw a precipitous decline in the activity levels of our clients as they struggled to come to grips with the abrupt financial impact on their businesses.

As mentioned on the previous call, approximately 67% of our commercial staffing business operates in the essential area of food manufacturing and related supply chain. At the moment, we are seeing revenue declines in Q2 of approximately 27%, with a similar movement in gross profit over Q1. Not all of this decline can be resolved by the overhead reductions that we have made, and therefore, our outlook for Adjusted EBITDA is between breakeven and a positive Q1 result.

As we moved through the impact across March, April, and May, we hit a bottom in early May and have been slowly recovering since then. Our temporary contractor headcount in February was 4,234, which reached a low in April of 3,355. May was a pretty slow month given the uncertainty in the market, but I'm pleased to note that as we exit June we are at 3,653 headcount, a 14% shortfall against February, and on a growing curve. We expect that we will add a minimum of an additional 400 more headcount in the month of July.

Currently, we have more than 800 open roles that we are working to fulfill, and have a number of sales proposals for which we await client feedback. We fully expect to return to February levels at some point during Q3, but, of course, that is dependent upon how quickly the hiring patterns of our clients recover. Our world still has a way to go in terms of the U.S. and U.K. unemployment and furlough.

During the month of May, we repaid a $2.5 million short-term loan to Jackson Investment Group, which was originally due on December 31, 2019. During the period of January to May, this was incurring an 18% interest rate and the issuance of £100,000 of shares of common stock each month. With the repayment of this loan, we have removed this interest charge and the stock issuances.

As we enter July, we will be fully compliant with all of the cash payments due to the Jackson Investment Group in relation to our term loan and Preference E shares. We owe a huge debt of gratitude to the Jackson Investment Group, to MidCap Financial, and to HSBC Bank, our U.K. banker, for the support they have provided during this challenging period.

Despite the market uncertainty and the major impacts on both of our U.S. and U.K. economies, we have used the time prudently to clean up some issues and to put our business on a more solid financial footing.

I will now hand the call over to Sharnika Viswakula, our Corporate Controller and Principal Accounting Officer, for a further update. Sharnika?

Sharnika Viswakula

Thank you, Brendan, and good morning, everyone.

For the first quarter of 2020, revenue of $58.7 million reflects a decrease of 20.5% over the prior year of $73.8 million. The decline was driven by $0.2 million of unfavorable foreign currency translation and $14.9 million of organic decline.

Revenue during the quarter was comprised of $56 million of temporary contractor revenue and $2.7 million of permanent placement revenue. The temporary contractor revenue is now approximately $4,300 per week, down from approximately $5,600 per week in the prior-year first quarter and is down by 8.5% from approximately $4,700 per week in the fourth quarter of 2019. We ended the quarter with approximately 4,300 temporary contractors versus approximately 5,000 last December.

Gross profit for the quarter of $10.6 million decreased $1.5 million, or 12.1%, over the comparative first quarter of the prior year. Gross margin for the quarter improved to 18.1% versus 16.4% in the prior-year first quarter largely driven by a shift from lower-margin customers to higher-margin customers in the U.K.

Operating expenses for the quarter were $14.7 million, an increase of 29.4%, or $3.3 million. The increase in operating expenses were primarily driven by a goodwill impairment of the firstPRO reporting unit of approximately $3 million, higher non-recurring costs, legal and other costs associated with acquisition targets.

Loss from operations was $4.1 million versus $750,000 in the prior-year comparative quarter.

Other expenses for the quarter totaled $3.1 million versus $523,000 in the comparative first quarter of the prior year. This was primarily driven by losses from re-measuring the Company's intercompany note in the first quarter of 2020 of $675,000 compared with gains of $351,000 in the first quarter of 2019.

In addition, in the comparative first quarter of the prior year, the Company recorded a gain from the settlement of deferred consideration of $847,000 and recorded other income of $286,000.

The Company also had higher interest expense and amortization of deferred financing costs in the first quarter of 2020 compared with the first quarter of 2019 of approximately $410,000.

This performance translated intercompany's net loss of $7.2 million compared with a $229,000 net income in the prior year.

EBITDA declined approximately 227% to a loss of $4 million over the $3.1 million profit reported in the first quarter of the prior year, and Adjusted EBITDA declined approximately 40% to $1.2 million.

Finally, with respect to operating cash flow, including proceeds from accounts receivable financing, we reported a breakeven in the first quarter of 2020 as compared with negative $2.9 million in the first quarter of 2019. This was a result of successful management of our accounts receivable aging, particularly in the U.K., and our overall cost controls, most of which will flow through to the second and third quarters.

I will now hand the call over to Alicia Barker, our Executive Vice President and Chief Operating Officer.

Alicia Barker

Thanks, Brendan and Sharnika, and thank you to everyone who has joined us for today's call.

I'm pleased to report that 18 of our 21 offices have successfully reopened since our first reopening, which was on June 8. Our New York headquarters reopens on July 6, and the employees from the remaining closed offices are now working out of an alternative branch location.

The long list of safety precautions and preparations we've taken in anticipation of returning to our offices include: daily self-certifications of health for each time anyone goes into an office; cleaning and sanitizing; the provisioning of PPE equipment, including thermometers to all of our staffs; an abundance of visual signage for social distancing; maximum capacity limitations; coordinated efforts with building management; and continuing and ongoing communications with clients and contractors.

While we're hopeful that the States will allow businesses to continue to operate from an office environment, we are well-prepared to turn on a dime if we need to do so.

As I shared on the last call, STAF proactively transitioned to a remote workforce prior to any formal mandates. We saw what was coming and we knew that swift action was imperative to keep our employees safe and our business fully operational. Since then, I've been asked by several people how we knew to react so quickly. We did not know more than anyone else. What we did know was that hesitating or acting too slowly could be devastating. It was the leadership of our Executive Team, in partnership with local management and operations, that enabled us to continue to service our clients with the same level of urgency they are accustomed to and require.

We know that we're running a marathon with COVID, and that this is not a sprint. We're proceeding with due caution in this dynamic environment and have prepared contingency plans for what may lie ahead. We're ready.

Brendan noted the $4.2 million reductions we took out of our business late March through early April, and we conducted some additional reductions and furloughs since our last call, primarily driven by the productivity of our clients.

In our business, we always have to be prepared to shift our workforce quickly. We have adjusted our overhead and support staff to balance the current number of sales and recruiters, and we have brought back a few employees from furlough, and again, that was driven by the need for onsite employees in our commercial staffing business stream.

We also focused a lot of our attention on collaboration and cross-selling between the brands throughout the organization. In this environment, it's sometimes necessary to pivot or reinvent oneself.

Last year at this time, our Lighthouse Professional Services brand was primarily a temporary contracting business. Today we're generating approximately $100,000 in permanent contracting fees every month.

On our last call, I mentioned that we'd be shifting our focus to the reopening plan while we continue to closely monitor the evolving regulatory and safety guidelines. There's a Staffing 360 global reopening plan, which can be found on our website for anyone who may be interested in taking a more detailed look. There are a variety of mandates from the federal and local governments in both countries in which we do business.

We assigned a special task force, and under Brendan's leadership, I directed the efforts of this task force to deliver a reopening plan that allowed for increased collaboration, the growth, client service and productivity, with both safety and customer service being the pillars of our foundation, and I'm pleased to report that we've had a very successful reopening thus far.

Our strategy included a full communications plan with every client, employee, and contractor, and our reopening plan consists of three phases.

Phase one, which is the phase we're in now, is completely voluntary and considers the needs of those individuals in high-risk categories. We're planning for phase two where a level of in-office attendance will be required, and we're hopeful that we'll be able to implement phase two in July. Phase three will bring us back to as close to normality as is possible in the current environment.

As you all know, we're a growing company with an aggressive acquisition strategy, and we can't grow and onboard new employees with a solely remote workforce. I'm happy to note that our employee engagement and morale has never been higher, and everyone at Staffing 360 Solutions is determined to succeed against whatever obstacles are thrown our way.

Our core values of honesty, integrity, belief, transparency, and tenacity has been on proud display these past few months, and it's been an honor to work in partnership with Brendan and the Executive Team.

Before I turn our call back over to Brendan, I'd like to let you know that in the current climate of social injustice in the U.S. and beyond, each day we continue to honor our mission to be good humans and to be good corporate citizens. We do this by respecting and actively supporting diversity. We are guided both in thought and in deeds by the five pillars of our core value system.

I will now hand the call back to Brendan.

Brendan Flood

Thank you, Alicia.

In relation to the various government stimulus programs, we have continued to participate in the employer payroll tax deferral program. This plan allows for the deferral of FICA taxes on an interest-free basis with repayments due, 50% in December 2021 and 50% in December 2022. We have purposely been executing on this since the beginning of April, with payroll tax savings amounting to approximately $110,000 per week. This is expected to amount to $4.3 million of cash flow support through to December 31, 2020.

During May, we applied for and were granted a total of $19.4 million in forgivable Paycheck Protection Program loans known as PPP. It is our intention, and it has been our activity so far, to utilize these loans for their prescribed purpose so that the final level of forgiveness will be total or materially forgiven.

We continue to look at the requirements of the Main Street Lending Program with our investment banker, R.W. Baird. Although there are further guidance details yet to come out which will outline our potential participation, we are already collecting and organizing the materials about the performance of the Company and its prospects so that we are prepared to act once the guidance has been issued.

On our last call, I mentioned that our U.K. banker, HSBC, had been very proactive in ensuring continued liquidity for that part of our business. We did receive £1 million of liquidity in the form of a low-margin, three-year term loan with six months of repayment reprieve that was due at the beginning of June. The bank also gave us a six-month holiday on the existing £0.5 million loan that was outstanding, and it has been partnering with us through these challenging times.

We have no reason to see the staffing market in any different way to other peer firms that have already opined upon it, and we reiterate our previous view that 2020 will continue to be a challenging year. As I said earlier, we are seeing some recovery, and based on discussions with clients about their needs and plans, we expect the second half to be a continuing growth period with a much stronger recovery in 2021.

At the moment, our internal corporate focus is on keeping our employees safe and on refinancing our balance sheet. Consequently, we have put any M&A activity on hold for several months while we deal with these important issues.

With that said, I'd like to thank you for giving us your time and attention this morning. I wish you good health and safety.

Operator, I would like to hand the call over to you for our Q&A session.

Operator

Thank you. Ladies and gentlemen, we will now conduct a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up the handset before pressing the star keys. One moment, please, while we poll for questions.

Our first question today will come from William Gregozeski with Greenridge Global.

William Gregozeski

Hi, Brendan. Congratulations on continuing to take advantage of all the different cash and deferral opportunities that are out there for you guys.

You mentioned still looking into the Main Street Lending Program. Are you guys looking into other sources for refinancing the debt, or are you just focusing on that right now until the details of that program come out?

Brendan Flood

Good morning, Bill, and thank you.

Our principal focus right now is on Main Street Lending, and it really depends upon where we get to with that. We feel somewhat confident, but you never know until you know, and you've never refinanced until you've refinanced, so that is where 90% of our focus is right now, but we always look at plan B, so we have been in discussions with our existing debt holders as to what our alternatives are in dealing with them going forward, but right now our focus is on Main Street Lending.

William Gregozeski

Okay, and you said second-quarter revenue was down—looking down 27%. Was that from the first quarter of this year or the second quarter of last year?

Brendan Flood

It's from the first quarter of this year.

William Gregozeski

Okay, and then can you just talk a little about your clients, which ones you're seeing - not specifically, just generally - coming back now or what might take longer to come back?

Brendan Flood

I mentioned earlier that 67% of our commercial staffing business is in food manufacturing or its related supply chain, so the area where we are seeing the greatest level of recovery is in commercial staffing, as that other 33% starts to reopen and starts to re-engage our temporary workers.

The biggest challenging part we have is in our permanent placement businesses both in the U.S. and the U.K. on professional staffing where it is a great challenge for some of our clients to engage candidates or to offer to candidates without meeting them first, so video calls are phenomenal and they're a great opportunity to get to know candidates, but quite often our clients are saying that's all well and good, but we still need to meet the candidate in person before we'll make a final offer, so it is probably the permanent placement business on professional staffing that is the slowest to recover.

William Gregozeski

Okay. All right. Thank you.

Operator

As a reminder, to ask your question, please press star, followed by the digit one. And we’ll pause for just a moment.

Next, we'll hear from Paul Denby with Denby Enterprise.

Paul Denby

Good morning, Brendan.

Brendan Flood

Good morning, Paul, and congratulations on your Form 13 announcing that you're now one of our largest shareholders, so welcome to the family.

Paul Denby

Thank you.

Alicia touched on a little bit about this and you mentioned on the last call about your early success in cross-selling between your different divisions. Can you tell me how that's improving and what—how much of an effect do you see that in the long term?

Alicia Barker

Paul, good morning. It's Alicia. Nice to hear your voice.

Paul Denby

How are you?

Alicia Barker

I'm good. Thank you.

Sure, happy to discuss that, so one of the advantages to having so many brands in our umbrella is to allow those brands to introduce other opportunities to each other, so our Clement May brand, which is one of our brands in the U.K., has introduced two other U.K. brands into the BAT client; both Longbridge and CBSbutler, and two-and-a-half or three years ago, when I first started with STAF, all of these businesses operated primarily as standalone operations. It really wasn't something that the businesses did, and now we have the brands working together in a way where they're consistently looking for opportunities to introduce one another, so if there are financial positions to fill at BAT, we have a brand that can do that. If there are engineering positions that need to be filled at BAT, then Clement May will introduce CBSbutler to do that.

Another good example is CBSbutler has introduced the JM Group into its new cyber security clients, and then, in the U.S., Lighthouse Professional Services has introduced our commercial staffing business, Monroe Staffing, into Swarovski, so we try to really make a point of making sure that we optimize all of the openings that our clients have and try to capitalize having as many of our brands work on each of those openings as possible.

Paul Denby

That's great. Well, thanks for the answer.

Alicia Barker

Absolutely. Stay safe out there in North Carolina.

Paul Denby

I will.

Alicia Barker

Good.

Operator

This marks the end of our question-and-answer session today. I'd now like to turn the call back to Brendan Flood for any brief closing remarks or comments.

Brendan Flood

Thank you, Operator.

The entire staffing industry and the economies of our two main markets are working through unprecedented and challenging times. I am confident that we've been on the forefront of meeting those challenges, and time will tell whether the challenges will become greater or not. We are hoping for the best, and as is our responsibility, planning for less favorable outcomes. I'm confident that we will come out of this downturn stronger than we went in.

I extend my thanks and appreciation to our talented and hardworking staff and Management Team whose actions are directly responsible for seeing us through this first phase of this storm.

I'd also like to commend the governments of both the United States and the United Kingdom for the stimulus activities they've undertaken to date and those that may still come.

Our industry is committed to getting people back to work as quickly as possible, and we look forward to playing our part in that. We anticipate that we will continue to drive improvements to our operational performance, and to continuing to drive and maintain shareholder value as we progress on our path toward our goal to build a profitable $500 million 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. That will conclude today's call. We thank you for your participation.