Transcript of
Staffing 360 Solutions, Inc.
Fiscal Q2 2020 Results Conference Call
August 12th, 2020

Participants

Brendan Flood, Chairman & Chief Executive Officer
Sharnika Viswakula, Corporate Controller & Principal Accounting Officer
Alicia Barker, Executive Vice President & 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 Q2 2020 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 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, August 12, 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 measure.

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, Orlando, and thank you to everyone who has joined us for Staffing 360's fiscal second quarter 2020 financial results conference call. I am 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 continuing in my hope that everyone is staying healthy and safe during this unprecedented COVID-19 pandemic. The well-being of our staff, contractors and clients has continued to be our main priority since the virus was discovered and the outbreak spread to our geographies.

I will begin with an overview of our financial and operational performance covering the second 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 the COVID-19 pandemic and our continuing response to it. I will finish by outlining what we are seeing performance-wise in the third quarter, what our near-term plans are in relation to intended refinancing of our business, and then the line will be open for questions.

As outlined in our press release yesterday, revenue for Q2 2020 was $43.3 million with gross profit at $7.6 million. Both metrics are exactly in line with the numbers previously guided to on the Q1 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 legislation also in the U.K., along with a deep impact in April and early May of the COVID-19 pandemic. On a sequential basis, our Q2 revenue was down 26% against Q1, with gross profit down 28%. From a weekly billing perspective, what we have seen across the first half was January at $4.4 million; February, up to $4.8 million; March, back to $4.4 million; April decline of 17% to $3.2 million; and then we start to see constant growth as we're up 4.4% in May to $3.3 million and up 5% in June to $3.5 million.

At the end of March and the beginning of April, we took a $4.2 million of annualized overhead out of the business and followed this up with a further $1 million of annualized savings during Q2. These overhead savings have allowed us to manage against the worst impact of the pandemic so that we continue to deliver positive EBITDA for the quarter—positive Adjusted EBITDA for the quarter of $0.5 million. You may recall that the guidance stated that we would be between breakeven and the Q1 number of $1.2 million. Our adjusted SG&A in Q2 was $7.1 million against $9.4 million in Q1.

From a cash management perspective, we continue to manage it tightly across the quarter but did take the opportunity to clean up certain areas and liabilities on our balance sheet and are now totally compliant with all payments skew on the various Jackson Investment Group investments in us, including the note for $2.5 million that matured in December 2019, and which was attracting an elevated interest rate of 18% and 100,000 shares of common stock per month.

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 second quarter of 2020, revenues of $43.4 million reflects a decline of 41% over the prior year of $73.5 million. The decline of $29.4 million was driven by the impact to sales due to the COVID-19 pandemic and declining unfavorable foreign exchange of $0.7 million. Revenue during the quarter was comprised of $42 million of temporary contractor revenue and $1.4 million of permanent placement revenue. The temporary contractor revenue is now approximately $3.2 million per week, down from approximately $5.5 million per week in the prior year second quarter.

We ended the quarter of 2020 with approximately 3,590 temporary workers and contractors. This decline is driven by the impact to our business from the COVID-19 pandemic. However, since April 2020, we have seen an upward trend in our weekly revenues, and more recently, have seen an increase of approximately 9% or $300,000 per week at the end of the last week in July as compared with the second quarter of this year. Gross profit for the quarter of $7.6 million decreased by 37.5% from $12.1 million in the prior year. Gross margin improved to 17.4% versus 16.5% in the prior year quarter, largely driven by a shift from lower-margin customers to higher-margin customers in the U.K.

Operating expenses for the quarter were $9 million, a decrease of 22.1% from $11.6 million from the prior year. The decrease in operating expenses were driven by the Company's actions to reduce the negative effects of the COVID-19 pandemic through various cost-cutting initiatives, such as decrease in salaries and wages and reduction in nonrecurring costs, legal and other costs associated with refinancing and acquisition methods.

Loss from operations were $1.4 million as compared with income from operations of $515,000 in the prior year comparative quarter. Our expenses for the quarter remained consistent at $2.3 million compared to prior year. This performance translated into a net loss of $3.8 million compared with a $1.5 million net loss in the prior year quarter. EBITDA declined by approximately 185% to negative $0.8 million compared with positive $1 million and Adjusted EBITDA declined by 78% to $0.5 million from $2.4 million in the prior year quarter.

Turning to the balance sheet and cash flows. The more significant changes from December '19, are the PPP loans from the FDA of $19.39 million and funding of £1 million from HSBC in the U.K. We also paid off a short-term loan of $2.5 million in May of 2020 that was due to Jackson Investment Group at the end of December 2019.

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

Alicia Barker
Thank you, Brendan and Sharnika, and thank you, everyone who has joined us for today's call.

Since our last update, when 18 of our 20 offices had successfully reopened beginning on June 8, I am very pleased to report that all of our offices are now open, and we have had growing attendance in the offices on a weekly basis.

I'll remind you that Phase one of our reopening plan was completely voluntary. That said, during Phase one, every member of our executive and local leadership team had a physical presence in every one of our offices. We encouraged attendance and meetings slowly. And now as I look around today, I see that our New York headquarters is fully staffed. We have capacity limitations based on state and country guidelines, and as a company, we continue to insist that attendance allows for six feet of social distancing.

As more people return to the office and acknowledge the excellent safety protocols that were implemented, word is catching on, and people are more comfortable returning. Fortunately, 87% of our staff drives to work, and in the cities of New York and London where public transportation continues to cause a level of anxiety, we have arranged reimbursements for parking a car service so that all of those employees can safely get to work.

We have now announced that the Company will transition to Phase two of our reopening on Monday, August 17th. The primary difference and actually the only difference between Phase one and Phase two is that Phase two requires that each employee comes to an office a minimum of two days per week. We've had very candid and regular communications with our global team and it's our opinion that the predictions at the end of the office are premature and sensationalized. Companies like Facebook and Google who are offering fully remote work are not a good comparative staffing agency. We're a growing company, and salespeople and recruiters were assessed collaboratively, in the bullpen, on the floor to optimize employee engagement and productivity.

The long list of safety precautions and preparations we've taken in anticipation of returning to our office will not change at all between Phase one and Phase two. As I said on our last call, this includes daily self-certifications of health each time anyone goes into an office, cleaning and sanitizing, the provisioning of PPE equipment, including thermometers to all staff, visual signage for social distancing, maximum capacity limitations, coordinated efforts with building management and continuing communications with clients and contractors.

While we are all hopeful that the states will allow business to continue to operate from an office environment, we are well prepared to turn on the dime if we need to do so. Under Brendan's leadership, our team managed this very successfully under sudden and extreme circumstances. Should we find ourselves in this position again, we've now gained a depth of experience, knowledge and upgrades to payroll automation and onboarding contractors that will serve us well. Brendan noted the $5.2 million of reductions we took out of our business late March through early April on our last call. We've continued to monitor that expenditure rigorously.

I said on our last call that our employee engagement and morale has never been higher. The most recent results of our formal employee engagement survey through Thomas International came in this month and indicates that our levels of employee engagement are above the benchmark and much higher than average. We asked employees to measure engagement through relationships, roles and reward. Workplace engagement is associated with high levels of performance and organizational well-being, and we will use the results of this survey to continue to drive performance and change behaviors in action where we need to.

I'd like to take a moment to share my appreciation of the continued responsiveness and exceptional work ethic of our staff under these less than ideal conditions.

I will now hand the call back to Brendan.

Brendan Flood
Thank you, Alicia.

At the moment, we are seeing revenue improvements in Q3, with July 15% up on its equivalent month of April. Overall for the quarter, we are anticipating that revenue will be up 20% over Q2 with gross profit similarly improving. With cost controls, our Adjusted EBITDA should return to the Q1 level or a little better.

When I look at our temporary contractor numbers, we averaged Q1 at 4,500. We dropped to 3,200 in April and have now entered Q3 with 3,800 in July and 4,050 in August. So, August is now 26% higher than our low point of April. Our expectation is that our pipeline of activity will bring us pretty much to the Q1 levels or better by the end of September. The strongest area of growth is being seen in our commercial staffing business stream, but we are seeing some green shoots of recovery in the professional staffing businesses also.

Our pipeline of new activity is stronger than it has ever been, with a number of large opportunities presented to us that we are evaluating. These are typically lower margin contracts, but with judicious cost controls, we can make a comparable EBITDA margin on them.

In relation to client engagement, we have not seen any margin pressure. We did have some clients furlough our temporary workers, but these are now returning, which is driving our growth. While there are no guarantees in relation to how this pandemic develops, our business along the eastern seaboard and in the U.K. are now in towns and cities where the reproduction rates are generally holding steady, which is why Alicia has outlined our Phase two return-to-the-office program. However, as stated, should anything change, we now have the capability to pivot on a dime and to move to full remote working again.

The development of communication platforms such as Zoom or Microsoft Teams has allowed us to be fully in communication with each other and has highlighted the importance of strong IT in the modern world and for the staffing industry in general, both as a tool and a product offering.

The forgiveness process for the Paycheck Protection Program started on August 10, and we are currently bringing our paperwork together to start the process. Approximately 96% of our loans were used for the purpose of payroll employees, with the remainder used for payments of rents in our offices that lay empty during the lockdown periods. We are confident that we will justify total or almost total forgiveness on the $19.395 million of loans received from the small business administration.

In relation to other 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 been purposely executing on this since the beginning of April, with payroll tax savings amounting to approximately $110,000 per week. This is expected to add $4.3 million of cash flow support between April and December 31, 2020.

We continue to review the role that mainstream lending program can provide with our consultant, R.W. Baird. On Monday of this week, we hosted a webinar for potential debt providers, and we await the outcome of that call and the level of interest that it may have raised. We continue to see the staffing market in the same way as our 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. 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.

To sum it up, our solid business pipeline and diverse client base provide a measure of stability to our business. Our position in relation to M&A remains unchanged from last quarter and that our focus is on refinancing our balance sheet and keeping our employees safe. Consequently, we have put any M&A activity on hold for several months while we deal with these important issues.

With that said, I appreciate you giving us your time and attention this morning.

Operator, I would now 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 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.

We'll hear from William Gregozeski with Greenridge Global.

William Gregozeski
Hey, Brendan, nice quarter. It sounds positive for the third quarter as well.

In the past, you've talked about how difficult some of your markets were with very low unemployment. Now that we're seeing that swing hard in the other direction, can you just talk about how you see kind of, near-term and longer term, the potential for the business with rising unemployment and more people available?

Brendan Flood
Sure. No problem. Historically, I think I've mentioned the Atlantic market was pretty close to zero unemployment. And therefore, it's quite challenging for our *first*PRO consultants in placing people. And firstPRO had a quite a challenging lockdown period, but what is very positive is that during the month of July and August, the revenue and gross profit numbers for *first*PRO have increased materially. Permanent placements are starting to become a little bit easier to complete as clients do gain a better understanding that they may have to place people via a Zoom call rather than in person, which was one of the struggles that they had during the course of April and May. That is helping us.

The $600 unemployment benefit was a challenge in some of our commercial staffing areas in that certain number of people were earning more being unemployed than they would ever earn by being employed. The fact that it's now come down to $400 has created a little bit more of a stimulus and an availability of candidates across commercial staffing. We have continued to see that grow. We still have somewhere in the order of 800 to 1,000 open roles within our commercial staffing business that we are working our way through filling, and we'll work our way through filling most of third quarter.

So, it certainly helps. Having zero unemployment is totally unhelpful but having a certain amount of healthy employment—unemployment helps us. I do reiterate, I don't remember if I said this on the last call or not, but the amount of people who are unemployed now in both the United States and the United Kingdom is a huge opportunity for the staffing industry in general because neither government and neither economy can afford to have that many people unemployed. , I do think 2021 will be quite a phenomenal growth year for us.

William Gregozeski
Okay. Great. Then you talked about the Main Street Lending and kind of refinancing Jackson. Is there any update you can provide on the receivable financing?

Brendan Flood
I would say that right now we are very happy with our relationship with MidCap Financial in the U.S. and with HSBC in the U.K. Both groups have been incredibly proactive for us. Our main focus is in refinancing our term debt. If that should come along with the same requirement to work on our accounts receivable financing, then we will look at it. But the principal focus on their Main Street Lending is the refinancing the Jackson debt from our balance sheet.

William Gregozeski
Okay. Likely to assume you'll just extend MidCap?

Brendan Flood
I would say that's likely, Bill. Yes.

William Gregozeski
Okay, all right. Thank you.

Operator
An additional reminder, if you would like to ask a question, please press star one on your telephone keypad.

Next, we'll take a question from Paul Denby with Denby Enterprises, Inc.

Paul Denby
Hi Brendan, I hope everybody is still doing well. Sounds like it.

Congratulations on surviving this pandemic in the workforce. Obviously, it seems like to me now you've really got this business right back on track. I guess I was going to ask you if you can expand a little bit. If you expect your employment to be back even in September, would that put you back on the path of where you were as far as a $300 million business? That's the first question.

Brendan Flood

Okay. So, I mentioned that we'll be back on the pre-pandemic levels of contractors by the end of September. Therefore, we should derive an Adjusted EBITDA number similar to Q1, if not a little bit better. So that's what we expect.

In terms of the growth rates towards being $300 million again, we've obviously lost somewhere in the order of one and half quarters in that growth rate. So, we're a little bit behind the curve. The pipeline of activity that we have and the two major projects that we are evaluating, one of which may happen in September, October, one of which may happen in January, but neither happened until they actually happen. We're still evaluating those. But most certainly, if they come off, then we are back above $300 million again. If they don't, we do still have a very robust pipeline in our large accounts team in commercial staffing. We do have a lot of our professional staffing clients who are returning to work mode in both the U.S. and the U.K. We do have our largest client, which has recently appointed us as a tier one supplier, not just in the U.K. where we principally were but also in Poland, Romania, Malaysia, Costa Rica and Mexico. We're looking for a healthy growth in our relationship with that client going forward. There's a lot of stuff going on, Paul. There's a lot of reasons to be optimistic.

Paul Denby
Yes. It really sounds great. I mean, it's just amazing that this company is still so undervalued with the potential, and what you've done with the balance sheet, what those PPPs allowed you to do. Of course, all the FICA deferment, especially in relation to what your peers have been doing, I don't think any one of them is faired anywhere near as well as Staffing 360. Again, thanks for the hard work for your staff, and good luck.

Brendan Flood
Thanks, Paul. I do think, as an industry, that we have a phenomenal opportunity for everybody to succeed. This market is huge. We don't spend a lot of time challenging or competing with other staffing companies. The pie is big enough for everybody to actually do incredibly well.

Operator
This 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
Thank you again, Orlando. Staffing 360 Solutions has continued to be at the forefront of meeting the challenges of COVID-19 and its economic damage. I continue to be confident that we will come out of this downturn stronger than we went into it.

I extend my thanks and appreciation to our talented and hard-working staff and management team whose actions are directly responsible for seeing us through the first phase of this storm. Visibility into the marketplace is improving, and our entire 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 while continuing to guide and maintain shareholder value as we progress on our path toward our goal to build a profitable $500 million revenue company.

I wish you good health and safety. 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.