Transcript of
Staffing 360 Solutions, Inc.
Fiscal Q3 2020 Results Conference Call
November 11th, 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, everyone, and welcome to the Staffing 360 Solutions Fiscal Q3 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 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 and actual results to differ from those contained in our forward-looking statements. All forward-looking statements are made as of today, November 11, 2020, and Staffing 360 Solutions expressly disclaims any obligations to revise or to update any forward-looking statements after the date of the conference call.

During these prepared comments, we may make reference to the 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, Celeste, and thank you to everyone who has joined us for Staffing 360's fiscal third quarter 2020 financial results conference call. Joining me today are Alicia Barker, our Chief Operating Officer, and Sharnika Viswakula, our Corporate Controller and Principal Accounting Officer.

This quarter, I will once again start my remarks with good wishes for everyone's health and safety as we continue to fight through the COVID-19 pandemic. The well-being of our staff, contractors and clients has remained our key priority since the virus was discovered as the outbreak spread across the world.

I'll begin with an overview of our financial and operational performance, covering the third quarter of 2020. Then, I will turn the call over to Sharnika for further details, after which Alicia will provide an update, including the operational impact of the COVID-19 pandemic and our ongoing response to it. I will finish by outlining what we are seeing performance-wise as we look to the fourth quarter before the line will be open for your questions.

As outlined in our press release yesterday, revenue for Q3 2020 was $48.6 million, with gross profit at $8.3 million. 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 a slower-than-expected recovery from the COVID-19 pandemic. On a sequential basis, our Q3 revenue of $48.6 million was up 12.2% against Q2, with gross profit up 10.2% for the same period.

From a weekly billing perspective, we continue to see continued sequential improvement since May, when we were up 4.4% to $3.3 million; up 5% in June to $3.5 million. In July, we were up 4.7% to $3.6 million; in August, we had an increase of 5.5% to $3.8 million; before September being slightly down at $3.7 million.

Our total contracted numbers at the end of September were 3,903, a level we had not seen since February before we went into shelter-in-place and lockdown. In Q1 and Q2, we took $5.2 million of annualized overhead out of the business. We followed that with a further $1 million of overhead removed in early October. These overhead savings have allowed us to manage against the worst impact of the pandemic into what we hope is a recovery phase, so that we continue to deliver a positive Adjusted EBITDA for the third quarter of $1.2 million, in line with our guidance on the previous call.

Our adjusted SG&A in Q3 was $7.1 million, flat against Q2 and 26% or $2.5 million lower than Q3 of 2019.

I'm pleased to recap the recent restructuring for our two senior debt agreements and the extension of both for a two-year term. Our new senior secured debt agreement with Jackson Investment Group allows us to strengthen our financial position and provides considerable flexibility. The significant benefits of this restructuring include:

- The two-year extension being important as it provides us with a meaningful runway in which to refinance the loan and our total debt prior to its maturity
- It reduces our cash outflow by 50% from the previous facility
- It further reduces $1 million in interest expense in the first six months and moves out for two years, the potential conversion of the preferred shares.

Our ability to complete a more attractive refinancing in 2021, will provide us even greater flexibility to build organic growth and for M&A-driven expansion in the future, enhancing our ability to achieve our long-term goals. In the near term, we will focus significantly more on enhancing organic growth than on M&A growth. Our strategy remains around M&A, and when the market recovery is a lot clearer, we will return to the M&A market as a strategic growth option.

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

Sharnika Viswakula
Thank you, Brendan, and thank you, everyone, for joining us today.

Revenue was $48.6 million for the third quarter of 2020, a decline of approximately 28% over the prior year of $67.3 million. This does not include approximately $500,000 of sales from firstPRO since its divestiture in September 2020. The decline of $18.7 million was driven by a combination of IR35 in the U.K., the loss of a couple of key clients, namely a payrolling business in the U.K. and a client in the U.S. that filed a Chapter 11 bankruptcy for which we recognized a bad debt expense of approximately $880,000. The remainder of the decline in sales is due to the continued impact to our business from the COVID-19 pandemic, offset by a favorable foreign exchange of $0.8 million. The Company did see signs of recovery in the third quarter of 2020, whereby our sales increased by approximately 12% as compared with the second quarter of 2020.

Revenue during the third quarter of 2020 was comprised of $47.1 million of temporary contractor revenue and $1.5 million of permanent placement revenue. The temporary contractor revenue is now approximately $3.6 million per week, down from approximately $4.9 million per week in the prior year third quarter. We ended the third quarter of 2020 with approximately 3,900 temporary workers and contractors, a decline from the third quarter of 2019 of approximately 5,100, driven by the impact to our business from the IR35 in the U.K. and the loss of a couple of key clients as discussed previously.

Since the end of the third quarter of 2020, the Company is continuing to see an upward trend in our weekly revenue, and more recently, have seen an increase of approximately 5% or $200,000 per week in October 2020, as compared with September 2020. Gross profit for the quarter of $8.3 million, decreased by 33.3% from $12.5 million in the prior year. Overall, gross margin declined to 17.1% versus 18.5% in the prior year. This is largely due to a lower permanent hiring fee compared with last year. Gross margin for permanent placement was $1.5 million in the third quarter of 2020 as compared with $3.6 million in the same period last year.

Operating expenses for the quarter was $10.2 million, a decrease of 16.9% from the $12.2 million in the prior year. The decrease in operating expenses was driven by the Company's action taken to reduce the negative effects of the COVID-19 pandemic through varied cost-cutting initiatives, such as a decrease in salary and wages and a reduction in nonrecurring costs, legal and other costs associated with refinancing acquisition efforts. This decline in operating expenses was offset by bad debt expense recognized of $880,000 as a result of the client filing for chapter 11 bankruptcy in the U.S. Loss from operations was $1.8 million as compared with income from operations of $0.2 million in the prior year comparative quarter. Other expenses for the quarter declined to $0.8 million from $1.3 million compared with prior year.

In September of 2020, we divested our firstPRO business and recognized a gain on the sale of approximately $220,000. This performance translated into a net loss of $2.6 million compared with a $1.1 million net loss in the prior quarter. EBITDA declined by approximately 113% to negative $0.2 million compared with a positive $1.8 million in the prior year, and Adjusted EBITDA declined by 58% to $1.2 million in the third quarter of 2020.

Turning to the balance sheet and cash flow, the more significant changes from December 2019 are PPP loan from the FDA of $19.39 million, of which $10.8 million is reflected as current liability and $8.6 million is reflected as noncurrent liabilities. We had funding of £1 million from HSBC in the U.K., and we refinanced the receivables financing facility in the U.K. for a further 12 months. We paid off our short-term loan of $2.5 million to Justin Investment Group in May 2020.

We divested our firstPRO business with $3.3 million during the third quarter of 2020, $1.3 million of debt was used to redeem the Series E preferred stock subsequent to the third quarter 2020. Subsequent to the third quarter of 2020, we also refinanced the MidCap AR financing facility, extending the maturity date by two years. We also refinanced our debt with Jackson subsequent to the third quarter of 2020, extending the

Company's debt with Jackson by two years, and as such, this is being shown as a noncurrent debt on the balance sheet of the third quarter end.

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

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

Since our last update, we continue to track daily the rates of contagion in each state and country where we have an office or service to clients. Internally, we use a threshold of 1.5 as our R-rate to determine when we pivot to a fully remote working environment. Our offices in the U.S. have remained in Phase 2 with the exception of an occasional shutdown and deep clean because of a COVID breakout. Fortunately, because of our safety protocols and the continued good choices of our staff, that has been a rare occurrence. We transitioned to Phase 2 of our reopening plan mid-August and as a reminder, Phase 2 is a hybrid schedule that has our staff working in offices and remotely per state guidelines. We continue to believe that our productivity and client service is supported with the energy that comes from in-person collaboration whenever possible. This ongoing diligence requires discipline on everyone's part, and the team is to be commended.

The long list of safety precautions and preparations we've taken has not changed with the exception of permitting in-person interviewing in our commercial staffing business. I mentioned on our last call, these safety precautions include daily self-certifications of health each time anyone goes into an office, cleaning and sanitizing, the provisioning of PPE equipment to all staff, visual signage for social distancing, maximum capacity limitations, coordinated efforts with building management, and ongoing communications with clients and contractors.

Many of the contractors in our commercial staffing business don't have regular access to a computer, so in-person interviewing is a necessary part of doing business. To date, we have not had a single incidence of in-person interviewing spreading COVID in our offices. While we're hopeful that the states will allow businesses to continue to operate from an office environment, we're well prepared to turn on a dime if we need to do so. We recently had to return to a fully remote work in London and Red Hill after Prime Minister Boris Johnson's mandate. Under Brendan's leadership, our team continues to manage a constantly shifting landscape very successfully.

Brendan noted the $5.2 million of reductions we took out of our business late March to early April on our last call. The additional million taken out in October is a reflection of our regular diligence to ensure that we're operating as efficiently as possible. Our teams have absorbed the work of their colleagues with grace, and as you all know, it's not easy to manage that during an economic downturn. In addition to the reduction, we've made wise operational investments, including recent decisions to upgrade our payrolling capability in both the U.S. and the U.K. This decision is anticipated to save us a combined total of $450,000 in 2021. Additionally, it protects our ability to pay our contractors, which is a necessity in any staffing company in the face of many weather and pandemic related challenges that we anticipate heading into this winter.

I'm very proud to share with you all that Brendan recently signed the CEO and action pledge for diversity and inclusion. Brendan was one of the first staffing company CEOs to sign this pledge. As one of more than 1,300 CEOs that have come together for CEO action for diversity and inclusion, Brendan made a very real and formal commitment of himself and our organization to advance diversity and inclusion in the workplace. By signing this commitment, we've taken to pledge to take action and to cultivate a workplace where diverse perspectives and experiences are welcomed and respected and where employees feel encouraged to discuss equity and inclusion.

Over the summer, we assembled an international task force, and in late October, we named Kate Simpson our International Senior Vice President of Equity and Inclusion. Kate has reported to me over the past year in an international capacity driving program and delivery of learning and development, engagement and human resources programs throughout the Company.

We firmly believe that it is not enough for an organization to be diverse. We must create equity within that environment and Kate's appointment is a reflection of our ongoing commitment to that effort. We welcome the opportunity to join the pledge and ensure we're doing our part to educate staff about institutional racism, micro aggressions in the workplace and unconscious bias.

The CEO action for diversity and inclusion is led by a steering committee of CEOs and leaders from Accenture, BCG, Deloitte U.S., The Executive Leadership Counsel, Ernst & Young, General Atlantic, KPMG, New York Life, Proctor & Gamble and PwC. The coalition represents 85 industries, all 50 of the United States and millions of employees globally. If you're interested in learning more about the pledge, visit ceoaction.com.

I'd like to close my comments by sharing my appreciation to our entire staff for their continued responsiveness and exceptional under less than ideal pandemic conditions.

I'll now hand the call back to Brendan.

Brendan Flood
Thank you, Alicia.

Today, we are seeing revenue improvements early in Q4 with October 12% up on its equivalent month of July in Q2. We anticipate that Q4 revenue will be 12% over Q3, with gross profit similarly improving. With effective cost controls, our adjusted EBITDA should show improvement on Q3. As I mentioned earlier, we exited September with 3,903 contractors on billing, a level we had not seen since February. The general business outlook and our pipeline of activity leads us to expect that we'll close Q4 with continual improvement as we continue to look forward to achieving pre-COVID numbers at the year-end.

Strongest area of growth continues to be in our commercial staffing business stream, and the young green shoots of recovery I spoke about in Q2 in the professional staffing businesses are maturing nicely. I'm encouraged to note that we have not seen, nor do we see now any margin pressure in our client engagement. We did have some clients furlough our temporary workers in the first half of the year, but these positions continue to return and to drive our growth.

As I've noted previously, while no one can predict and there are no guarantees how this pandemic develops, our business along the Eastern Seaboard and in the U.K. are now in towns and cities where the virus reproduction rates are generally holding steady. However, should things change, we now have the capability to pivot on a dime and to move the full remote working as needed. The development and adoption of work-from-home communication platforms makes it possible and continues to highlight the importance of strong IT in the modern world and for the staffing industry in general, both as a tool and as a product offering.

We have filed our paperwork to initiate the forgiveness process for a Paycheck Protection Program stimulus funds. We remain confident that we justify total or almost total forgiveness on the $19.395 million of loans received from the small business administration and are hopeful that we will know more by the end of the year. We continue to participate in another government stimulus program, 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've had payroll tax savings amounting to approximately $75,000 to $110,000 per week since April, and this is expected to add more than $4 million of cash flow support between April and December 31, 2020. We regularly review additional stimulus programs with a view towards utilizing those for which we may qualify. While it's an understatement to say that 2020 has been a challenging year for the staffing market, I am optimistic as we continue to see increasing recoveries in both the United States and the United Kingdom.

We're in the people business and remain in very close contact and have ongoing discussions with clients about their immediate needs and future plans. We are seeing the ongoing growth we expected to materialize in the second half of the year and look forward to a much stronger recovery in 2021. It's important to note that our solid business pipeline and diverse client base provide a measure of stability for our business during this time.

Regarding our position in relation to M&A, it remains unchanged from last quarter and that our focus is on refinancing our balance sheet and keeping our employees safe. Consequently, our M&A activity is on hold while we prioritize these important matters. I appreciate 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. If you'd like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star, one to ask a question, and we'll pause for just a moment to allow everyone an opportunity to signal for questions.

We'll take our first question from William Gregozeski from Greenridge Global.

William Gregozeski
Hi, Brendan, it sounds like things are still progressing positively for you. On the 12% increase for the fourth quarter, can you talk about how that's going to break out between the commercial business, which looks like it's doing really well, and the professional, which seems to be more impacted by lockdowns and restrictions?

Brendan Flood
Sure. Thanks, I agree with you that we are continuing to show a lot of positive progress. The expectation is probably that the light industrial business will grow at a faster clip than the professional business, but the counter to that, Will, is at the gross profit level and that we are starting to see a significant uptick in permanent placement, which is really where the professional staffing businesses will start to grow their profitability in the fourth quarter and into 2021.

I'm actually generally expecting a similar uplift in both sides of the coin in the fourth quarter, and both of them to be equally positive. The meetings we've had with our various managers across all of our brands in the past week have shown incredibly positive returns. The pipelines are the strongest they've been the entire year. We don't have one revenue generator who has spare time in his or her day. Our productivity levels are back as high as they've ever been, and I expect the positivity to be recognized across both professional staffing and commercial staffing.

William Gregozeski
Okay. No big concerns with the U.K. being in lockdown and potentially more restrictions in the U.S., there's no concern that you guys might have a slide on the professional side again?

Brendan Flood
No, the counter to that is that the vast majority of our clients in the U.K. never came back from the first lockdown. Most of them said that they were sticking out until January or February 2021, so the fact that Boris Johnson came out and told everybody a few weeks ago that we should all work from home going forward made no difference to the vast majority of our client base.

William Gregozeski
Okay. All right. Last question is regarding your debt, you'll have the $3 million payment to Jackson by the end of January and then $2 million for the Series E redemption once you get the PPP forgiveness from firstPRO, do you expect to make any other kind of debt repayments of any kind in the next six months besides those two?

Brendan Flood
We're going to be fairly pragmatic about it. What we will do, as most companies will do, is to rally around our bank balance and just make sure that we have sufficient to cover every eventuality that comes forward. If we

continue to see the progress that we expect to see, and we will utilize our cash to bring down the debt as much as we can and save ourselves effectively still a headline 12% interest rate. The answer is we have no fixed plan right now. But if we can pragmatically bring it down, we will bring it down.

William Gregozeski

Okay, great. Thank you.

Operator

Again, if you would like to ask a question, that is star, one. That is star, one to ask a question. It looks like there are no further questions. 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, Operator. Staffing 360 Solutions has continued to be at the forefront in meeting the challenges of COVID-19 and its economic damage. Our productivity, as I've just answered in the previous question, remains strong. Our sales pipeline is active and looking robust. Our confidence level remains high that we will come out of this downturn better and stronger than we went in.

Contributions of our talented and hard-working staff, as mentioned by Alicia, and management team are directly responsible for seeing us through the worst of this storm, and I offer them my deepest gratitude and appreciation. Visibility into the marketplace is improving and our industry outlook continues to brighten. We'll continue to seek to drive improvements to our operational performance, while always driving to guide and maintain shareholder value as we progress on our path towards our goal, to build profitable $500 million revenue company.

I hope that you continue to enjoy good health and stay safe and all of us at Staffing 360 Solutions wish you a happy holiday season. Thank you, all, and I look forward to speaking with you again next quarter.

Operator, that is the end of our call.

Operator

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