# HireQuest (NASDAQ: HQI $6.88)

Fifty percent operating margins with a capital light business model don't normally come with a stock trading at *nine* times trough earnings. Nor do huge growth opportunities and a founder/CEO with heavy insider ownership, come along with a business that sells for an incredible *six* times next year's earnings. Did I also mention the company just announced a 3% annual dividend and has a buyback in place as well?

Let me introduce you to HireQuest (NASDAQ: HQI), a franchise staffing company that no one has ever heard of, but that is sure to be revalued substantially over the next six to twelve months.

**HireQuest's Franchise Model**

HireQuest is the only publicly traded staffing company that operates solely on a franchise model. HQI's focus is on day laborers. What kind of jobs do HQI's workers fulfill? HQI workers help load trucks, move materials on construction sites, hospitality, clean stadiums, help in recycling facilities, etc. Jobs known as light industrial work.

The total addressable market for staffing in light industrial is 37-40% of the total staffing market. HireQuest is a big player in their niche, direct dispatch, which is 10% of the light industrial market. HireQuest workers come to the local office and then are dispatched to work sites and HQI often even helps the workers coordinate transportation (with COVID there have been some changes in that often workers go directly to the site). The local franchised office also helps with any specialized equipment needs such as hard hats or goggles, and at the end of the day workers will return this equipment, collect pay and check out. HireQuest is primarily in the Southeast, Northwest, Texas and the Great Plains. HireQuest is not in California or New York, and has a limited presence in the Midwest, though it is in Indianapolis, Des Moines, Green Bay and East Chicago).

HQI is a very different kind of franchiser. They lend money to help support a strong franchisee and do not ask for upfront money for the purchase of a franchise. Instead, a franchisee pays back the "purchase" of the franchise through revenue and earnings. The company believes it is creating real entrepreneurs. Many times, HireQuest has cultivated talent inside their network, by getting star assistant managers to start new franchise branches in adjacent territories. From 2009 to 2018, almost all of HireQuest's growth was from lending to aspiring franchisees.

HQI allows franchisees to focus on recruiting day laborers and selling their staffing services to companies and organizations. HQI provides almost everything else including accounts receivable management, financing, workers compensation, technology and national accounts. The genius of the HQI system is to centralize and control the parts of the staffing business that don't need to be handled by a franchisee. Once you remove the financial hurdles, you are enabling franchisees to really just focus on sales and people. HireQuest's franchise model is one of the few that doesn't require capital from the franchisee if someone has the right profile, ambition and hustle.

HireQuest has been honing this business model since founder and CEO Rick Hermanns started franchising in 1998. There was a corporate structure and name change in 2002. The company's system is to strip out layers of management, unnecessary costs and other conflicts that plague other staffing companies. This enables superior operating margins.

The company made a giant step forward in growth when it acquired a publicly traded microcap company called Command Center. Then suddenly and very quietly, HireQuest was a publicly traded company.

**HireQuest "Went Public" by Acquiring Command Center**

Command Center was a vertically integrated, underperforming staffing company. Just look at the comparison.

| | HireQuest (Private) | Command Center (Public) |
|---|---|---|
| 2018 System Wide Sales | $189.3M | $97.4M |
| 2018 Revenue | $13.0M | $97.4M |
| 2018 Operating Income | $7.2M | $1.2M |
| # of Locations | 93 franchised branches | 67 corporately-owned branches |
| States | 20 | 22 |

How does a $13 million revenue company acquire a company with $97 million in revenue? Easy, when its net income is six times the company with the larger sales. This is how far superior HQI's business model is to the industry.

HireQuest "merged" with Command Center and then went about converting Command Center's operations to franchises. What did this entail? They went to the people actually running the day to day branch operations and asked if they wanted to be entrepreneurs and also offered existing franchisees to takeover any overlapping territories. With no money required upfront, they loaned the purchase of the franchise to these front-line managers, handled the workers comp and accounts receivable financing and then said go do your job.

What did this mean for those front-line managers of each "branch?" It meant for some their earnings doubled with no upfront payment. And it meant stripping away layers of useless management and cutting a lot of unnecessary corporate fat. After five years of earnout, these franchisees now own the business outright.

The most amazing part of the HireQuest acquisition of Command Center is that ***it appears as if HireQuest ended up getting paid to acquire Command Center.*** How? When you look at how much consideration Command Center got in the merger, Command Center shareholders received $25 million. However, HireQuest then turned around and "sold" $17 million of franchises to managers and employees and then also received $15 million of tangible net worth. So, HireQuest was paid $7 million to acquire a company with almost $100 million in revenue. This brilliant financial move shows the financial acumen of HireQuest management. That being said, this was actually a good deal for Command Center as well, as the company could not unlock earnings or value with its prior structure and management team.

And after the messiness of merger costs and restructuring Command Center into franchises, HQI was finally ready to showcase its true earnings power in March. And then COVID hit.

**Business Model Tested by COVID and Still Profitable in Q2**

It is hard to imagine a worse employment market for a staffing company than the second quarter of 2020, when most of the country went into shutdown. You would imagine HireQuest announcing big losses and experience financial pain. And yet, you would be wrong. HQI not only was profitable due to its lean franchise model, but its cash flow and cash balances went up substantially. Since HQI finances receivables, when business slows down, their receivable balances fall, and cash goes up. Since the end of the year, HQI's cash has gone up nearly $10 million, or $0.77 per share.

The capital light nature of the business is really attractive. All that is needed is capital to finance the accounts receivable and these receivables are highly financeable, making it unlikely that HireQuest would ever have to raise capital it didn't want to.

And despite a terrible economic backdrop, HQI is still on track to earn over $0.50 per share in earnings this year. Any business that can still earn money in this environment has one heck of a powerful business model.

**Approximately $1 Per Share in Earnings Power with Existing Franchise Network**

HireQuest earns money primarily three ways:

1. A royalty of 5-8% of a franchise's sales
2. Accounts Receivable financing
3. Workers Comp Insurance

Before COVID hit, HireQuest's franchise network was on track to earn $300 million in system-wide sales in 2020. A rough guide is that HQI should earn in post-tax earnings anywhere from 3% to 5% of systemwide sales. Using a base case of 4% on $300 million, nets the company close to $0.90 per share in earnings, and possibly over $1 per share if margins are on the higher end of the range.

The company's best quarter is typically Q3, while Q2 and Q4 come next and Q1 is the weakest. It has to do with how many working days there are in any quarter and weather is a factor as well. The best weather around the country is Q3.

HireQuest could see a surge in its earnings if a big infrastructure spending bill comes through. It may not matter if it is the Trump bridge and highway plan or the Biden Green New Deal, infrastructure spending would be a big boon to the company.

**Huge Opportunity to Grow Through Consolidation and Conversion to Franchise Model**

But beyond the economy recovering or an infrastructure bill, the company's big blue-sky opportunity is to roll up mom and pop staffing companies and convert them to its powerful franchise model.

HireQuest recently hired an investment banker from D.A. Davidson as a full time director of corporate development (link here: http://www.irdirect.net/prviewer/release/id/4427019) to accelerate the hunt for opportunities. If you read the deal proxy, you can see that D.A. Davidson was the investment banker for the Command Center side of the deal. It is fascinating that an investment banker for the other side of the deal has now left his investment banker job to work full-time for HireQuest. This seems to be pretty telling and significant.

Specifically, the company may want to expand outside of direct dispatch into the broader light industrial market to compete directly with Addecco (SW: ADEN) and Manpower (NYSE: MAN), but on smaller accounts. Those giant companies don't normally want to waste too much time or effort on small jobs, but with its mean and lean franchise model, this could be a rich vein for franchisees of HireQuest.

This is why the company is public and not a private entity, it can develop a powerful roll-up model and sit back and print money. The light industrial market is a $58 billion market. If HQI can take an additional ½ of one percent of the market through organic growth and acquisitions, it could add $300 million in system wide sales, doubling its earnings potential.

At a high level, HireQuest basically organizes large pools of unskilled and semi-skilled workers. The company is now asking itself, beyond its vertical, what other areas could it replicate its model. There may be opportunities in janitorial, security guards and truck drivers. The opportunity here is enormous if HireQuest can figure this out.

**CEO/Founder and Insiders Own Over 65% of the Stock**

All of this is driven by Richard (Rick) Hermanns, a founder/CEO, who started the very first version of HireQuest in 1991, almost thirty years ago. The official version of HireQuest launched in 2002. Eighteen years later, he now runs a publicly traded company in which he owns a hefty 43% stake.

With decades of experience, management has a keen understanding of the industry and the opportunity to grow. As large shareholders they also understand capital allocation and the importance of shareholder value. Just remember how they were essentially paid to acquire Command Center. This is the kind of team you want to invest with.

While the stock is illiquid, they still view their stock as cheap and initiated a buyback. The company recently started paying out a solid 3% dividend. I believe the only reason, HQI is not paying out more is the opportunity to acquire mom and pop shops. If for some reason, the acquisition opportunities do not materialize or do not materialize at the right prices, I expect the dividend to jump.

The biggest risk in investing in an illiquid microcap is that your money becomes trapped. With HireQuest's aligned management and a nice dividend and buyback, the risks are much lower of being stuck in a value trap.

**Short Term Opportunity to Acquire Shares from Legacy Command Center Shareholders**

Let's face it, this is a really illiquid stock right now because it is so closely held. The stock trades five thousand shares a day. However, this idea is timely because there are a few legacy Command Center shareholders who have been selling the stock around $6.50 to $7 per share. It is my belief that these legacy shareholders have created a short-term opportunity to buy somewhere between 500,000 to 1 million shares and this is what has been keeping the valuation so low.

These long time Command Center shareholders simply do not understand the new company or franchise system and how profitable and powerful it can be. Nor do they appreciate the valuations such successful franchise companies achieve when it becomes painfully obvious to market participants.

This is why HireQuest is so interesting right now, because once this supply is taken, the stock will move higher quickly.

**Valuation is Absurdly Cheap**

This stock is illiquid, I get it. But the valuation is absurd. HireQuest has a pristine balance sheet with $1.67 per share of cash and notes receivables. My estimate of this year's trough earnings is $0.55 per share, meaning the company sells for nine times trough earnings. My estimate of next year is $0.88 per share, meaning the company trades at an absurd six times next year's estimate or what the company would have earned in 2020 without the impact of COVID.

Comparatives are hard for HireQuest as most competitors are poorly run, have complicated financials or are giant companies.

One example is BG Staffing (NYSE: BGSF), another microcap staffing company that has a market cap of around $100 million, but it also has over $40 million in long term liabilities, so BGSF's true enterprise value is $140 million. The company's financials are really a mess, as they report "adjusted earnings" that exclude technology fees, transaction fees, amortization, stock comp and more.

BGSF had been seeing declining earnings before COVID struck and yet still trades for 13 times this year's earnings estimate that excludes a lot of true costs and 11 times next year's numbers and that is without taking into account the messy financials or the extra $40 million in debt.

Giant staffing company, Manpower, sells for 27 times this year's trough earnings and 14 times next year's estimate. But even this is a poor comparison because Manpower's margins are so much lower than HireQuest.

The magic of HireQuest is its franchising margins of 50% and the ability to make money in even the toughest of environments.

Some successful franchises you may be familiar with are Domino's Pizza (NYSE: DPZ) which sells for 35 times earnings as does McDonald's (NYSE: MCD). Super successful franchise companies with growth sell for outsized multiples. And this is where future acquisitions could really propel the stock. If they can execute on acquisitions, investors will reward the company with a giant valuation.

Even with more moderate assumptions though, the right valuation multiple for HireQuest is probably not to sell for six times next year's earnings.

The potential earnings power of HireQuest is simply enormous. The stock could easily be worth multiples of its current stock price.

| **HQI Valuation and Model** | | | | |
|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2023 |
| System Wide Sales | $ 215,000,000 | $ 300,000,000 | $ 425,000,000 | $ 600,000,000 |
| % earned | 3.5% | 4% | 4.3% | 4.5% |
| Net income | $ 7,525,000 | $ 12,000,000 | $ 18,062,500 | $ 27,000,000 |
| EPS* | $ 0.55 | $ 0.88 | $ 1.33 | $ 1.99 |
| *2020 operating earnings do not include increase in reserve in Q1 2020 due to COVID | | | | |
| | | | | |
| Multiple (plus cash and notes) | | | | |
| 15 | $ 9.98 | $ 14.92 | $ 21.61 | $ 31.47 |
| 20 | $ 12.75 | **$ 19.33** | **$ 28.26** | $ 41.41 |
| 25 | $ 15.52 | $ 23.75 | $ 34.90 | $ 51.34 |
| | | | | |
| Balance sheet | | | | |
| Current Stock price | $ 6.88 | | | |
| Shares out | 13,589,790 | | | |
| Market Cap | 93,497,755 | | | |
| Cash | $ 13,746,445 | | | |
| Notes | $ 8,990,279 | | | |
| Cash and notes | $ 22,736,724 | | | |
| Enterprise Value | $ 70,761,031 | | | |
| Cash per share | $ 1.01 | | | |
| Cash and notes per share | $ 1.67 | | | |
| Current P/E with cash & notes | 9.4 | | | |

**Risks**

This is an illiquid stock and only averages 5,000 shares a day. Illiquid stocks can make exaggerated, volatile moves when people want to buy and sell. Buyer beware.

The CEO and insiders own the majority of the company and there is always the risk that they do things that benefit themselves at the expense of shareholders. Having said that, I have found nothing alarming, and the recent actions around a dividend and buyback show a commitment to returning shareholder capital.

There are some related party issues to consider and be comfortable with. The CEO's children and the other large owner of stock Ed Jackson own 25% of the franchises (though they do not own them outright, they own interests in them). This is an outgrowth from the financial crisis of 2008, when they had to acquire these franchisees. All of this is disclosed in the company's 10K. I am confident that the company has strong independent board members, and this has been properly vetted. But it is worth paying attention to, especially if some disclosures change.

**Summary**

HireQuest is not only a phenomenal business, it has a superior business model with a long runway for growth that is run by a Founder CEO. Thanks to COVID and a few legacy Command Center shareholders who may not appreciate the earnings power of HQI's business model, investors have the chance to invest in the unimaginable, a company with 50% operating margins trading at a single digit earnings multiple. You just have to accept that the stock is a microcap and illiquid. But with a 3% dividend and a heavily aligned Founder CEO with a commitment to growth, it is a small price to pay. And HQI may be just the best low risk way to invest in the recovery of the economy.

**Catalysts**

-Solid Q3 earnings
-Acquisitions and growth
-Infrastructure Spending Bill
-Revaluation and any coverage for investors/analysts