Trickle Research

Every raging river, every great lake, every deep blue sea starts … with a trickle

Earnings Update: Q3-Fiscal 2018
Allocation Upgrade and Price Target Downgrade

Report Date: 11/13/18

12- 24 month Price Target (split adjusted): **$8.75

Allocation: *5

Closing Stock Price at Initiation (Split Adjusted Close 9/08/17): $4.44

Closing Stock Price (Close 11/12/18): $3.88

Command Center, Inc.

COMMAND CENTER®

(OTC Stock Symbol: CCNI)

Prepared By:
David L. Lavigne
Senior Analyst, Managing Partner
Trickle Research LLC

We have been covering CCNI for some time now, and we must admit, we seem to have a hard time nailing down the numbers one quarter to the next. After last quarter, we noted that we were *"paring back some of our estimates just to try to get them more in line with the results over the past few quarters where revenue comps have been flat"*. However, as it turned out, they reported revenues of $26.3 million which was just over $760,000 or about 3% higher than our revised estimate. The $26.3 million was about ½ way between the Q1 estimate we revised down, and the new number we revised *down to*. Frankly, all things considered, we were encouraged by the revenue number, although keep in mind, Q3 is typically the strongest seasonal quarter. Further, as management addressed on the call, revenues can be lumpy because of larger contracts that get started and completed in various quarters, which tends to mitigate the value of YoY comparisons. That is particularly true given the limited aggregate organic growth they are generally afforded. This is not a business that can generate marked organic growth for any sustainable period of time.

As for the balance of the numbers, it is certainly reasonable to assume that if they exceeded our revenue projections, they might likely outrun our earnings assessments as well. They did not, which almost certainly explains the weakness in the stock since the release. As for expenses, COGS were $19.86 million, which, given the level of revenues, we would have projected to be about $19.24 million, or about $600,000 lower. Management noted that roughly 75% of the higher COGS were related to higher workman comp items/estimates. That is disappointing, but it is not exactly unexpected or unforeseen. As we believe we noted in the initiating coverage (and have argued regarding this company for several years now) workman compensation issue are clearly one of the biggest risks in the business. Over the several years we have followed and covered CCNI, that has proven to be true and in a variety of forms and multiple points in time. Again, extended workman compensation issues are disappointing, not necessarily unexpected and fortunately not generally (consistently) recurring. It is what it is. In addition to workman compensation items embedded in the COGS, they also reflected some additional SG&A beyond what we modeled of about $128,000. However, once we adjusted the revenues upward, actual SG&A came in about $80,000 higher than that adjusted estimate. The Company noted on the call, that the quarter included some reconfiguring of bonus and compensation plans. We suspect most of the difference was related to those changes, and we have modified some of our forward estimates to account for that notion. Here again, given the entre of new management, presumably to addresses weakness in the operations, it should be no surprise to anyone that we might see some changes to the numbers to reflect the implementation of the new/modified plan. New management was brought in to make changes, so expenses related to those adjustments should not be unexpected.

Just to wrap up the reporting of the quarter and move on to other issues, we were happy with higher revenues, and not so happy about lower earnings. On the other hand, given the transitions we just mentioned, we don't find the earnings miss particularly telling one way or another. We expect more visibility as management and its associated plan settles in.

The above said, the stock perplexes us but we get it. CCNI is not the typical microcap "growth" stock. We submit, they have had trouble growing the business organically (which is not likely to change) and they have taken a very guarded approach to acquisition with the idea that they do not intend to go make acquisitions simply for the sake of expanding the top line. That is, they remain steadfast in the view that acquisitions need to make financial and operational sense. The *result* of that view (flat revenues) may not be what investors want to contemplate, but if continued profitability is the goal, then its hard to argue with the approach. That's the reality of CCNI. We submit, our original thesis and model assumptions did not contemplate a great deal of organic growth, but *they did* assume the consistent addition of some new (greenfield) stores here and there, and they did contemplate the notion of growth through acquisition as a potential open-ended part of the story (although we did not model that specifically). That said, the question becomes, if we remove those assessments and look at the valuation of CCNI through the limited growth lenses that have essentially been the reality over the past several quarters, where do we end up? Here is our best shot at that.

First, we submit, Command Center is not perhaps a typical "microcap" stock nor is it our typical coverage stock. It is not a growth stock although we admit, looking back, we expected more growth to this point largely because we anticipated they would have more locations by now. We already covered the rationale for why that has NOT happened, but again, we expected some acquisitive growth, but that aside, unlike many of the others we cover, it is not an organic growth story, and there are not particular identifiable catalysts (acquisition aside) that one would reasonably anticipate. From that perspective it is and has been more of a "value play". Again "value plays" are not typical in our research universe, but they are not necessarily *atypical* either. That may be an appropriate backdrop to the following narrative.

Recall, in Q1, the Company took an impairment charge of about $1.5 million related to a workman compensation deposit held by an insurer that declared bankruptcy. That quarter also included about $500,000 related to the severance of the prior CEO they replaced. Without those charges, the current 9-month net income would be approximately $1.3 million, and by extension, if we add our Q4 estimate of approximately $450,000 - $500,000, we think fiscal 2018 net income *would* have reflected something around $1.8 million or about $.38 per share (based on current shares outstanding). Given those same adjustments, we estimate that EBITDA for the same period would have come in around $.59 per share. Recall 2017 had some similar non-recurring adjustments, namely a tax charge related to the new tax law changes. For the sake of comparison, we estimate that in 2017, net income would have been about $1.63 million or $.32 per share (based on fully diluted share counts at that time). Consequently, if we strip out the extraordinary items, we should end 2018 with eps growth of roughly 19% and net income growth of just over 10%. Granted, keep in mind, 2018 net income and eps comps are aided by lower share counts due to stock buy backs and by lower federal tax rates. Setting the comps aside, if CCNI ends 2018 as we have projected, it means the stock is currently trading at about 10X trailing earnings (assuming 4Q 2018) and roughly 6.3X EBITDA. More importantly, given their cash position, it suggests that the stock is trading at an **Enterprise Value to EBITDA multiple of about 4**. ***In addition, the stock is trading at 1X book value…***

For the sake of comparison, the chart below www.siblisresearch.com reflects respective EV/EBITDA for various sectors of the S&P 500 over the past few years:

S&P 500 – EV/EBITDA Multiple by GICS Sector

GICS Sector	6/30/2018	12/31/2017	6/30/2017	12/31/2016	6/30/2016	12/31/2015
Communications	12.07	11.46	11.16	10.57	10.23	11.61
Consumer Discretionary	14.66	14.19	13.15	11.66	11.75	12.4
Consumer Staples	13.25	13.23	13.09	13.1	13.91	12.81
Energy	12.42	12.32	14.25	35.09	33.23	13.02
Health Care	14.58	14.87	14.06	11.77	13.55	13.6
Industrials	12.76	13.07	12.38	11.35	10.74	11.23
Information Technology	13.72	13.57	12.87	12.04	10.57	10
Materials	12.37	14.29	12.26	13.78	14.31	12.1
Utilities	11.02	11.96	12.06	11.99	12.43	9.78

The chart below reflects the Price to Book value of the S&P 500 for the past 20 years:

Date	Value
12-Nov-18	3.26 estimate
31-Dec-17	3.23
31-Dec-16	2.91
31-Dec-15	2.76
31-Dec-14	2.83
31-Dec-13	2.58
31-Dec-12	2.14
31-Dec-11	2.05
31-Dec-10	2.17
31-Dec-09	2.17
31-Dec-08	2
31-Dec-07	2.77
31-Dec-06	2.81
31-Dec-05	2.76
31-Dec-04	2.92
31-Dec-03	3.03
31-Dec-02	2.73
31-Dec-01	3.39
31-Dec-00	4.05
31-Dec-99	5.05

We won't belabor these comparisons because we think they speak for themselves, so we will move on.

We understand, that for much of the past few years, CCNI has generally underperformed expectations. In retrospect, those results have led to the replacement of two CEOs and now (at the direction of the third) some restructuring of the organization, albeit largely at the store level. We would add, in our view some extraordinary items have "muddied" the performance, which while not fantastic, has also not been nearly as disappointing as the stock seems to indicate. Just to reiterate, most of the extraordinary items have stemmed from workman compensation issues, which is an ongoing risk in the deal, but will probably be less topical in 2019 than 2018. We would add, despite the ongoing workman compensation a slowing economy likely remains the biggest wildcard here.

Looking ahead, we have made a few adjustments to the model to reflect what we believe is a tightening labor market (read: higher wages/COGS) as well as some additional SG&A to reflect more "reasonable" incentives (and perhaps by extension more aggressive management hires) at the store level. We have also lowered some of our expectations for new store additions since we have not seen much of that through 2018, but frankly, we didn't model a substantial amount of that to begin with. That said, we may still be aggressive by assuming any top line growth at all, but we are comfortable going there for now under the auspices that store level enhancements will bear some modest fruit. We did add an element to the model to reflect continued stock repurchases even beyond the current approved stock buy-back plan, because our sense is the if the stock continues to underperform in the face of prevailing or higher cashflow levels, the board will appropriately continue to buy the shares back.

Given the recent compression in the stock and our assumption of continued profitability and associated cash build, we are increasing our allocation of CCNI shares from 4 to *5 and setting a new (reduced) price target of **$8.75 reflecting some of our muted operating assumptions noted above. We will reassess each as additional data are made available.

Projected Operating Model

	(actual)	(actual)	(actual)	(estimate)	(estimate)	(estimate)
Income Statement						
Projected Operating Statement						
Command Center, Inc.						
By: Trickle Research LLC	(actual)	(actual)	(actual)	(estimate)	(estimate)	(estimate)
	3/30/18	6/29/18	9/28/18	12/28/18	**Fiscal 2018**	**Fiscal 2019**
Revenue	$ 22,467,398	$ 24,175,985	$ 26,309,035	$ 23,912,000	$ 96,864,418	$ 98,474,070
Cost of staffing services	$ 16,873,331	$ 17,898,665	$ 19,855,146	$ 17,931,120	$ 72,558,262	$ 73,519,035
Gross Profit	$ 5,594,067	$ 6,277,320	$ 6,453,889	$ 5,980,880	$ 24,306,156	$ 24,955,036
Selling, general, and administrative expenses	$ 7,213,620	$ 5,368,908	$ 5,630,260	$ 5,323,472	$ 23,536,259	$ 21,984,923
Depreciation and amortization	$ 92,591	$ 87,926	$ 72,548	$ 87,031	$ 340,096	$ 329,986
Income from operations	$ (1,712,143)	$ 820,486	$ 751,081	$ 570,377	$ 429,800	$ 2,640,126
Interest expense and other financing expense	$ 2,163	$ 267	$ (553)	$ (7,821)	$ (5,944)	$ (31,921)
Impairment of goodwill	$ -	$ -	$ -	$ -		
Change in fair value of derivative liability	$ -	$ -	$ -	$ -		
Net income before income taxes	$ (1,714,306)	$ 820,219	$ 751,634	$ 578,198	$ 435,744	$ 2,672,047
Provision for income taxes	$ (496,618)	$ 256,972	$ 205,284	$ 132,985	$ 98,623	$ 614,571
Net Income	$ (1,217,688)	$ 563,247	$ 546,350	$ 445,212	$ 337,120	$ 2,057,476
Earnings per share:						
Basic	$ (0.24)	$ 0.11	$ 0.12	$ 0.10	$ 0.07	$ 0.47
Diluted	$ (0.20)	$ 0.11	$ 0.12	$ 0.10	$ 0.07	$ 0.46
Weighted average shares outstanding:						
Basic	$ 4,983,157	$ 4,924,245	$ 4,714,924	$ 4,619,904	4,810,557	4,412,089
Diluted	$ 5,968,762	$ 4,931,201	$ 4,749,881	$ 4,670,990	5,080,208	4,513,103

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Rating System Overview:

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I favor the stock (at respective/current levels) more than a stock with a rating of 1. As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit $25,000 to buying micro-cap stocks, that would assume an investment of $1000 per stock (using the diversification approach we just mentioned, and the 20-stock coverage list we suggested and leaving some room to perhaps add another 5 of the names from our profiles). We generally start initial coverage stocks with an allocation of 4. Thus, at $1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same $250 we used in the example above. Thus, if we initiate a stock at a 4, you might consider putting $1000 into the position ($250 * 4). If we later raise the allocation to 6, you might consider adding two additional units or $500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units. Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those attached to more traditional rating systems (Buy, Sell, Hold) we would submit the following guidelines.

A Trickle rating of 1 thru 3 would best correspond to a "Speculative Buy" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.

A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.