Trickle Research

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

Target Upgrade

HireQuest™

HireQuest, Inc.

(Nasdaq Symbol: HQI)

Report Date: 10/06/20

Allocation: 5

12- 24 month Price Target (split adjusted): * $11.50

Closing Stock Price at Initiation (Split Adjusted Close 9/08/17): $4.44
Closing Stock Price at Allocation Increase (Close 11/13/18): $3.88
Closing Stock Price at Price Targe Increase (Close 10/05/20): $7.73

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Technically, we initiated coverage of HireQuest, Inc. just over three years ago when its was Command Center. Recall, in mid-2019, HireQuest was acquired by Command Center, but HireQuest was the surviving entity. While both enterprises are (were) temporary staffing companies, they were different in the sense that HireQuest utilizes a franchise model, while Command Center typically owned the stores in its orbit. We are not going to wade into the weeds of the advantages and disadvantages of those two models, however, we will note that we tend to believe that the franchise model is likely the more risk averse of the two. What we *will* weigh in on is this; over the period that we followed Command Center (which goes back further than our initiating coverage), the Company went through 3 or 4 management changes before arriving at current CEO Rick Hermanns, who is also the founder of HireQuest. To be clear, without deriding past managers, we do not think the Company has ever been in better hands and we think the numbers since the time of the acquisition support that view. We would add, we believe Mr. Hermanns currently owns between 40%-45% of the Company, so for those focused on management with "skin in the game", he certainly has that.

To refresh, the merger was first announced in April 2019, and was completed in mid-July (2019). We provided an update shortly after the release regarding the planned acquisition. For context, at the time of this release, the stock was trading around $5.50. Part of the transaction included a $6 tender offer for shareholders willing to sell back shares pre-acquisition. Here is the summary of that release:

> *In terms of valuation, the news release states that the combined entities believe that they can "produce annual EBITDA in excess of $15 million, exclusive of growth opportunities." To put that into perspective, we think the collective staffing industry trades with EBITDA/EV multiples of 8+. So then, 8X the projected $15 million of EBITDA would equate to a $120 million. If we take Command Center's portion of that value (32% post-merger) it implies a valuation for Command Center of $38.4 million. If we divide that by the roughly 4.7 million outstanding shares of Command Center, it comes to around $8.21 per share. If we assume that EBITDA will be in "excess" of $15 million and/or we use a bit higher multiple (several in the industry trade higher) then we get close to our $8.75 price target. To translate, we think the transaction is in the ballpark of fair, based on our targets/analysis.*
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> *We are not sure how to handle this from a research perspective. As we suggested, we believe our $8.75 target is more representative of fair value than the $6 tender offer. Further, we think the combination may prove synergistic, which would suggest that the best path here is to continue owning the (combined) stock. However, we will have to reassess continuing the coverage as we learn a bit more as this may be getting out of our wheelhouse. In the meantime, we are pleased to see something that begins to unlock some of the value we have been pounding the table about on CCNI.*

We spent the next few quarters following the acquisition (read: sitting on our hands) and observing HireQuest. In short, we did not feel like we had a good enough handle on the new business to add much insight from an analysis standpoint, but we also thought the Company was likely worth more than the market was giving it credit for, so we hung around. In late April 2020, we actually prepared a coverage termination overview, but we refrained from pulling the trigger on that and instead opted to see what the first quarter looked like. We thought the quarter, in the context of Covid19, was encouraging. Thereafter, we had a conversation with management, which was more encouraging and subsequently they released 2Q-F20 results, which again in the context of the pandemic, we thought were impressive. Succinctly, we are *reengaging* the research.

Through the first half of 2020, there were a couple of items worth noting in terms of the 1H performance. Most notably, despite the headwinds from Covid19, the Company managed to log pre-tax profits of nearly $2.3 million or about $.17 per share. That number included a write-down of $1.6 million related to notes receivable from franchisees. Absent the write downs, they would have recognized pretax profit of closer to $3.9 million or $.29 per share. Again, that number (aside from the write-downs) were achieved despite the impact of Covid19. Recognize, the notes receivable are largely related to the conversion/sale of (Command Center) company owned stores into franchise stores. The Company recognizes write-downs associated with these notes as follows; "*We monitor the financial condition of our franchisees and record provisions for estimated losses when we believe it is probable that our franchisees will be unable to make their required payments".* We submit, the write-downs were almost certainly related at least in part to franchisees' inability to pay notes due to Covid19 hardships. These write-downs are recorded in SG&A so future write-downs could negatively impact the operating results in that regard. In addition, the Company has worked to reduce SG&A due to the pandemic, so between that posture and the write-downs, we are not sure we know what "normalized" SG&A will look like. We will whittle that down as we move forward and gather some added clarity. We would add, while these note amounts have been written down, we expect the Company to continue pursuing their collection.

In addition to modeling expenses, we expect to miss some revenues as the U.S. continues to wrestle with Covid19. Obviously, overall employment will impact the Company's business. That said, we think we have modeled revenue that seems reasonable to us even in the context of a more challenging environment. Specifically, although again given the acquisition and the Covid19 nuances, it is difficult to pinpoint what normalized revenues are. Here again, we think our estimates are reasonable in the context of what we know and can see, but we submit, "the fog" of Covid19 will continue to complicate revenue visibility. Clearly, as with most other companies and industries across the country, the state of the general economy going forward will impact HireQuest's results.

One final point that we think is worth noting. As we said, despite Covid19 the company has managed to continue to generate profits and cash. Specifically, they ended Q2-F20 with cash of $13.7 million, which is roughly $1 per share, and they have no debt. The Company currently pays a quarterly dividend of $.05 per share, and they recently announced a 1 million share stock repurchase program.

The above noted, having had the opportunity to speak with management and review the filings since the acquisition, we reiterate, *"we do not think the Company has ever been in better hands and we think the numbers since the time of the acquisition support that view".* Further, while our models do not reflect the *annual EBITDA in excess of $15 million* that the Company suggested at the time of the acquisition, we would reiterate, we are attempting to model around risks that were certainly not apparent at the time of the merger. That said, we can see the path to $15 million in annual EBITDA. We will see how fast they get there. As a result of our updated analysis and our understanding of management's aptitudes in the space, we are reiterating our allocation of 5, and establishing a new 12-24 month price target of *$11.50 per share.

Projected Operating Overview

Income Statement						
Projected Operating Statement						
Command Center, Inc.						
By: Trickle Research LLC	(actual)	(actual)	(estimate)	(estimate)	(estimate)	(estimate)
	3/31/20	**6/30/20**	**9/30/20**	**12/31/20**	**Fiscal 2020**	**Fiscal 2021**
Franchise Royalties	$ 3,705,232	$ 2,639,287	$ 2,979,011	$ 3,172,730	$ 12,496,260	$ 18,247,552
Service Revenues	$ 414,739	$ 261,703	$ 397,452	$ 337,399	$ 1,411,293	$ 1,629,389
Total Revenues	$ 4,119,971	$ 2,900,990	$ 3,376,463	$ 3,510,129	$ 13,907,553	$ 19,876,941
Selling, general, and administrative expenses	$ 3,253,372	$ 1,931,076	$ 2,326,939	$ 2,108,530	$ 9,619,917	$ 9,736,481
Depreciation and amortization	$ 31,814	$ 32,402	$ 33,593	$ 33,303	$ 131,112	$ 130,240
Income from operations	$ 834,785	$ 937,512	$ 1,015,931	$ 1,368,296	$ 4,156,525	$ 10,010,219
Interest expense and other financing expense	$ (11,289)	$ (17,850)	$ (9,267)	$ (9,424)	$ (47,830)	$ (45,341)
Other Miscellaneous Income	$ 250,709	$ 288,837	$ -	$ -	$ 539,546	$ 0
Net income before income taxes	$ 1,074,205	$ 1,208,499	$ 1,006,665	$ 1,358,872	$ 4,648,241	$ 9,964,877
Provision for income taxes	$ 199,037	$ 51,497	$ 231,533	$ 312,541	$ 794,607	$ 2,291,922
Income From Continuing Operations						
Income From Discontinued Operations						
Net Income	$ 875,168	$ 1,157,002	$ 775,132	$ 1,046,331	$ 3,853,633	$ 7,672,956
Earnings per share:						
Basic	$ 0.06	$ 0.09	$ 0.06	$ 0.08	$ 0.29	$ 0.58
Diluted	$ 0.06	$ 0.09	$ 0.06	$ 0.08	$ 0.28	$ 0.57
Weighted average shares outstanding:						
Basic	$13,536,742	$13,547,950	$13,464,089	$13,383,573	13,483,089	13,161,131
Diluted	$13,680,565	$13,549,727	$13,636,101	$13,568,134	13,608,632	13,372,666

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Trickle Research co-sponsors two microcap conferences each year. Trickle Research encourages its coverage companies to present at those conferences and Trickle charges them a fee to do so. Companies are under no obligation to present at these conferences. HireQuest, (as Command Center) has paid fees to present at investor conferences co-sponsored by Trickle Research LLC.

Portions of this publication excerpted from company filings or other sources are noted in *italics* and referenced throughout the report.

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.