05-Nov-2018

TrueBlue, Inc. (TBI)

Q3 2018 Earnings Call

CORPORATE PARTICIPANTS

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

OTHER PARTICIPANTS

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Kyle Patterson
Equity Research Associate, Northcoast Research

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Sheryl and I will be your conference operator today. At this time, I would like to welcome everyone to the TrueBlue Third quarter 2018 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. Derrek Gafford, CFO of TrueBlue, you may begin your conference.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

Good afternoon, everyone, and welcome to the call. I'm here with our Chief Executive Officer, Patrick Beharelle.

Before we begin, I want to remind everyone that today's call and slide presentation will contain several forward-looking statements, all of which are subject to risk and uncertainties, and we assume no obligation to update or revise any forward-looking statements. These risks and uncertainties, some of which are described in today's press release and in our SEC filings, could cause actual results to differ materially from those in our forward-looking statements.

We use non-GAAP measures when presenting our financial results. We encourage you to review the non-GAAP reconciliations in today's earnings release or at trueblue.com under the Investor Relations section for a complete understanding of these terms, and their purpose. Any comparisons made today are based on a comparison to the same period in the prior year unless otherwise stated.

Lastly, we will be providing a copy of our prepared remarks on our website at the conclusion of today's call, and a full transcript and audio replay will also be available soon after the call.

With that, I'll turn the call over to Patrick.

A. Patrick Beharelle

Director & Chief Executive Officer, TrueBlue, Inc.

Thank you, Derrek, and thank you everyone for joining us on today's call. Our team delivered another quarter of revenue growth, gross margin expansion and strong EPS growth. Total revenue increased 3%. PeopleReady produced its second consecutive quarter of revenue growth and PeopleScout achieved its fifth consecutive quarter of double-digit organic revenue growth.

Gross margin increased by 110 basis points from efforts to lower our cost of sales, making this our 11th consecutive quarter of expansion. Earnings per share increased by 20% as a result of stronger business results, a lower effective income tax rate and share repurchases.

Now, let's take a closer look at the performance of each of our three businesses. PeopleReady is a leading provider of on-demand labor and skilled trades in the North American industrial staffing market. Our local relationships, national footprint of physical branch locations and growing use of technology help clients find contingent industrial labor quickly and efficiently.

PeopleReady represents 60% of trailing 12 months' total company revenue and 55% of combined segment profit. PeopleReady drove much of the strength in our results this quarter with growth accelerating to 3% versus 2% last quarter, despite 2 percentage points of headwind from additional revenue in our energy business and additional business from Hurricane Irma in Q3 last year.

From a strategic standpoint, we're leveraging JobStack to drive our long-term differentiation in the marketplace, while our near-term focus is squarely fixed on driving local business development activities. We're pleased with the underlying growth trajectory of the business with improvements that are broad-based across most industries and geographies which increases our confidence in the sustainability of our growth.

PeopleManagement, our second largest business, at 31% of revenue and 16% of combined segment profit provides onsite workforce solutions in the North American industrial staffing market. Revenue was down 8% or roughly flat when excluding the loss of the Amazon account and the PlaneTechs divestiture that was completed in the first quarter of this year. As a reminder on Amazon, in July, we announced they would be taking their Canadian business in-house effective September 1, consistent with the strategy they began to employ in the U.S. in the second half of 2016.

Looking ahead, PeopleManagement continues to offer a compelling value proposition that reduces labor costs through an onsite workforce solution.

Turning to our last segment, PeopleScout is the global leader in filling permanent positions through our Recruitment Process Outsourcing and Managed Service Provider offerings. PeopleScout represents 9% of revenue, but 29% of combined segment profit, given its attractive margin. Revenue grew 44% through a combination of organic growth and acquisition growth. Excluding TMP, the UK-based RPO provider we acquired in June this year, organic revenue was up 13%. The integration of TMP is off to a great start and is performing in line with our expectation.

Looking ahead, we are excited about the opportunity to leverage Affinix, our proprietary talent acquisition technology, to further differentiate the PeopleScout service offering. We also look forward to using the additional global delivery capabilities brought by the TMP acquisition to further compete for multi-continent RPO engagements.

Before handing it over to Derrek for a more in-depth review of results, I'd like to share some perspective on the human capital space and provide an update on our key strategic initiatives. The pace of change in connecting people to work is rapidly evolving, particularly when it comes to talent acquisition and workforce management. Widespread skill shortages, the need for just in time workforce adjustments, and an increasingly tight labor market are making it more challenging to get the right people in the right position at the right time.

Job candidates are also increasingly turning to technology to find the work they want, when they want it. Many of our strategic priorities are squarely focused on digitally transforming how we connect people and work. We are excited about the progress of our digital strategy with the deployment of our JobStack mobile app at PeopleReady and the introduction of Affinix at PeopleScout. JobStack is a next-generation mobile app that algorithmically matches workers with jobs and allows our customers to initiate orders. We successfully completed the roll-out of the worker app in 2017 and associate adoption rates climbed to 77% during the third quarter of 2018, exceeding our 70% target for the year.

In addition, the percentage of jobs being filled via the JobStack app, what we call our digital fill rate, came in at 30% for the quarter, not far from our 35% year-end goal. From a client perspective, we finished Q3 at 10,000 clients on JobStack, meeting the objectives that we set for the year, adding approximately 3,000 clients in the quarter. As we've shared in the past, we're finding that JobStack is helping us boost both worker and client loyalty, and we continue to see better overall performance from branches that have more aggressively adopted JobStack.

Looking forward, our focus for 2019 is squarely on enhancing the JobStack experience for associates and clients, and leveraging JobStack to drive incremental revenue. Our efforts in 2019 will be concentrated on three areas. First, strategically ramping our digital marketing efforts to grow our associate base and attract clients we may not reach through traditional branch-based efforts. Second, adding functionality that makes it even easier for clients and associates to partner with PeopleReady. And third, introducing referral and rewards programs to further increase JobStack utilization among associates and clients.

Turning to PeopleScout, Affinix is our proprietary next-generation talent acquisition technology that provides job seekers a user-friendly experience by allowing customers to quickly fill requisitions. It streamlines the recruiting process and creates a consumer-like experience for the candidate, making it a world-class candidate attraction technology. Affinix is receiving a great deal of interest from existing and prospective customers. We're in the early stages of the client onboarding process. The fully integrated Affinix platform has two clients live with another six planned to launch by the end of the year.

There are another 68 clients currently utilizing components of the system. We expect Affinix to continue to provide a competitive edge in deal pursuits and provide elevated value for our client base as the system is implemented more broadly. Another strategic initiative of ours is growing our global RPO presence through our PeopleScout business. In June, we announced the acquisition of TMP, a leading provider of RPO services, resourcing and recruitment marketing services in the United Kingdom. As a reminder, TMP creates opportunities for us across Europe and enhances our ability to compete for multi-continent RPO engagements.

The UK is the second largest RPO market in the world, and also one of the most common markets included in multi-continent RPO deals. The TMP acquisition brings us a physical presence and referenceable clients, and is already paying off as we've had a handful of international wins. TMP also has a strong employer branding practice, which adds to our suite of RPO services.

A final strategic initiative I'll discuss is our focus on returning capital to shareholders through share repurchases. Year-to-date through September, we repurchased $25 million worth of stock, and we have $68 million remaining under our existing authorization. It's our plan to remain active and opportunistic buyers of our stock, given our favorable long-term outlook for the business. I'll hand the call over to Derrek for a more in-depth review of our financial results.

Derrek L. Gafford

Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

Thank you, Patrick. Total revenue of $680 million, exceeded the high-end of our $662 million to $677 million expectations due to PeopleReady's performance. Net income per diluted share was $0.61 and adjusted net income per diluted share was $0.79, which was towards the upper end of our $0.75 to $0.81 expectations.

Adjusted net income per share increased by $0.19 or 32%, out of this increase roughly $0.10 was from a lower effective income tax rate, $0.07 from operational performance and $0.02 from a lower share count.

Gross margin of 27.1% was up 110 basis points. The improvement in gross margin was driven primarily by lower workers' compensation expense at PeopleReady and the addition of higher margin business at PeopleScout.

SG&A expense was up $14 million, with $4 million of the increase from higher adjusted EBITDA add-backs, $3 million from the ongoing operating costs in the recently acquired TMP business, and the remainder from core operations.

Adjusted EBITDA was up 7% and the margin was up 20 basis points. Our effective income tax rate came in at 13%, less than our 16% expected rate as a result of higher Work Opportunity Tax Credits.

Turning to our segments, PeopleReady revenue grew by 3%, an improvement over the 2% increase in Q2 and the decline of 5% in Q1. The growth in Q3 was broad-based with 16 of the top 20 states experiencing growth. Segment profit was up 9% and profit margin was up 40 basis points as a result of revenue growth and higher gross margin.

PeopleManagement revenue declined by 8%, or after excluding the Amazon account and PlaneTechs divestiture was flat. Segment profit was down 11%, or up 2% excluding PlaneTechs and Amazon, while overall segment profit margin was roughly flat.

PeopleScout revenue was up 44%, or 13% on an organic basis. Segment profit was up 21% and segment profit margin was down 330 basis points due to the acquisition of TMP in June. As we mentioned in the last quarter, TMP purchases recruitment media on behalf of certain clients and the pass-through nature of these costs creates margin dilution.

Our balance sheet remains a source of strength. Total debt of $108 million is down from $119 million at the beginning of the year, and our debt to total capital ratio is 16% compared to 18% at the beginning of the year.

On a trailing 12-month basis, our total debt to adjusted EBITDA multiple stands at 0.8 compared to 1.0 at the beginning of the year. Year-to-date cash flow from operations totaled $69 million and capital expenditures were $11 million netting to free cash flow of $58 million.

Returning capital to shareholders continues to be a priority. Year-to-date through September, we repurchased $25 million of common stock representing about 40% of free cash flow.

Let's turn to our outlook for Q4. We expect total revenues to decline 2% to 4%. Let me provide some color on why the mid-point of this range negative 3% is 6 percentage points lower than growth of 3% in Q3 2018.

The loss of the Amazon account represents an additional headwind in Q4 2018 of 3 percentage points, as the fourth quarter of 2017 was the highest volume quarter for this account. The energy business at PeopleReady will also contribute 3 percentage points of headwind in Q4 2018 due to a quarterly peak in Q4 of 2017.

Excluding these two headwinds, Q4 revenue is expected to increase about 2% to 4%. The prior revenue headwinds I just mentioned are considerably smaller starting in the first quarter of 2019. Please see today's earnings release presentation for more information on this topic.

Turning to profitability, we expect net income per share in Q4 of $0.34 to $0.41, or $0.55 to $0.62 on an adjusted basis, which assumes a share count of 40 million and an effective income tax rate of 16%.

We are focused on three simple principles to grow shareholder value. Our primary focus is centered on increasing organic revenue to drive a higher adjusted EBITDA margin. With another quarter of growth at PeopleReady, our largest segment, we're optimistic about the future due to its potential to produce a 15% plus operating margin and incremental revenue. Likewise, PeopleScout, our highest margin segment, continues to become a larger mix of our total business with double-digit organic revenue growth.

Our second priority is the effective management of our costs to further enhance our adjusted EBITDA margin. Our focus on lowering the cost of services has helped produce 11 consecutive quarters of gross margin expansion.

Third is the effective management of capital to boost shareholder return and earnings per share growth. With our growth strategies primarily focused on organic growth, we expect a larger proportion of free cash flow to be available for share repurchase.

This concludes our prepared comments. Operator, you may now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Kevin McVeigh of Credit Suisse. Please go ahead. Your line is open.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you. Hey. Hey Patrick. I wonder as you settle into the new role, you folks did a real nice job on the margin, just gross margins overall. Any thoughts on kind of initiatives you're focused on to continue to kind of optimize the business here as you are settling into a new role?

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

Well, from a margin perspective obviously, safety is one of the first things as it comes to mind. The safety training and the safety programs that we have to drive down our workers' compensation cost has been a big priority for the organization.

Another area that we've been focused on is pricing with our clients. And so, as wages are increasing – we're seeing minimum wage increases, as well as just market forces that are driving up wages, we're looking to price our engagements with our clients in a way that you know we're able to get a good return for shareholders.

So, those are two of the big ones. By the way, we are making some investments. We'll continue to make investments in our field organization and PeopleReady because what we're really focused on is trying to drive the top-line.

And so, we've added some resources from a recruiting and a sales perspective that that is partially offsetting sort of our overall EBITDA percentage there. So, safety is a big part. Pricing is a big part. Derrek, I don't know if you have anything you'd like to add just for those two?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

I think, those are the main things. I think the other opportunity that we have a lot of room here is in our local account business at PeopleReady, this is from a mix perspective. So local accounts that's an internal term here that would be synonymous with small to mid-sized business account groupings that you hear other companies talk about that's not only a piece of the business that's been lagging from a growth perspective that's now starting to catch up.

It's also important from a profitability perspective because that group of business runs about 60% of PeopleReady's business and the gross margin profile on that business runs about 400 basis points higher. However, the cost to serve to actually recruit the folks, get them to the job sites is the same as the rest of our business. So that's an important area that we're focusing on, one, because of the size of the growth potential from a revenue perspective at PeopleReady but also because of the favorable margin profile that also brings.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then Derrek, could you just remind us what the bill rate increases were this quarter versus last quarter?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yes. So the bill rate increase for this quarter was – actually, I'll give you both.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Overall bill rate increase for the company was 4.8% here in Q3 and then in Q2 it was 4.6%. So these are year-over-year increases in our average bill rates.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then just my last question was, has that Amazon business has been running off, does that help the gross margin and I'm assuming, and then how much is that business going to impact kind of if maybe Q4 or what are you modeling for 2019 in terms of – does that business totally come off in 2019 or I guess, when does it stop being a headwind to revenue?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah. Amazon does impact that gross margin profile but very nominally. I could look it up at and there might be 10 basis points in there but it's not going to be much more than that. From a headwind perspective, now everyone – I'm just going to mention, so I'm going to answer your question directly, Kevin. I'm going to refer everybody else, so that is reading the transcript of this call to our earnings release deck that provides more break-out on all this but – on Amazon. But let me give you the information.

The biggest headwind coming up for us is in the fourth quarter. In fourth quarter of 2017, we did $24 million of revenue with Amazon and about $2.5 million of profit. Coming into 2019, we will be anniversarying a comp at Amazon of about $12 million in Q1 of 2018 that has $1.5 million of profit. And then Q2 and Q3 of 2018, both run about $6 million of revenue and profit around $600,000 to $700,000.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Very helpful. Thank you.

Operator: Your next question comes from the line of Jeff Silber of BMO. Please go ahead. Your line is open.

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

Hey, guys. It's Henry Chien, calling for Jeff. I wanted to ask about the mobile app and sort of the impact that's had on the PeopleReady business? I know in the past you mentioned that you could potentially expand the pool of labor and also increase the sort of the potential jobs out there to fill, is that sort of what you're seeing and beyond the efficiency gains on SG&A or operational-wise?

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

Yeah. Thanks, Henry. This is Patrick. I appreciate the question. Just a couple of headlines on – on our mobile app. We've got over three quarters of our workers now that are using the app, just under a third of the positions that we're filling are being filled via the app and we've signed up over 10,000 clients at this point on to the app. So we've made a lot of progress in terms of laying groundwork to have a successful environment. One of the things we're seeing from a lift perspective is if we look at our sort of top quartile of branches, it's about 100 or so.

There are over 50% of the positions being filled in their branches via the app and what we're seeing there is between a point and two points higher of revenue growth in those branches. And so, we're seeing some lift. It's hard to say how much lift we're going to see out in the future; we're not providing guidance on that, but we're definitely seeing some lift from an overall revenue perspective in those branches that are highest adopters.

I think the real challenge for us is to get all of our branches up over 50%, and we've reached a tipping point where we can start to look at redeploying resources to spend more time on customer service and sales activities. And so those branches that are over 50% we're seeing some of that today. And so, we're working real hard to get all of our branches up to that level. And we're adding about 3,000 clients a quarter on to the tool. And that creates some real advantages for us because these clients are ordering directly through the tool. That creates a more frictionless environment and frees up a lot of time in our branches.

So, that's where we're at from a mobile app perspective. We will be coming out in the next call around some new goals for 2019 in terms of the client adoption and the percentage of jobs being filled with the tool. But we're expecting that those numbers can go up by a pretty material amount in 2019 versus what we've achieved in 2018.

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

Okay. Great. And I appreciate the update. And may be more of a broader macro question from your perspective in terms of looking at the end markets or your end market clients set. Are you seeing any disruption from trade, or any kind of change in sort of the rate of growth or demand?

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

Well, from a trade policy perspective, we had talked about on one of our earlier calls, back in Q1, that we saw some headwind related to solar. And we've kept in pretty close contact with all of our clients and haven't seen much change in demand related to trade policy other than what we mentioned on our first quarter call around some of the headwinds in solar, but we're monitoring it closely with our clients and talking to them every day. There's certainly some caution out there but we haven't seen it impacting our business.

Henry Sou Chien
Analyst, BMO Capital Markets (United States)

Q

Yeah. Okay, great. Thanks so much.

Operator: The next question comes from the line of Mark Marcon of R. W. Baird. Please go ahead. Your line is open.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.
Q

Good afternoon. I was wondering could you talk a little bit about the gross margins on the staffing side. It looks like workers comp helped to improve that. Was that related to current period cost in terms of the Q3 or prior period accrual reversals?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.
A

Hi. Good afternoon, Mark. Thanks for the question on that. Yeah. So, in the workers' compensation, we had some reductions to reserves both for reserves put up this year as well as reserves in prior years that ran about 90 basis points. So what we've been seeing here is both some movement in our current year accrual rate as well as prior years. But the main benefit though in most of that call it at least 75% of the benefit was from reserves put up on prior years.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.
Q

Okay. How are you thinking about the gross margins going forward on – in terms of just bill pay spread? And I'm wondering also a little bit about what you're seeing in terms of wage inflation, there's been a few companies like Amazon that have basically talked about $15 minimums, what sort of impact does that have?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.
A

Yeah. Well, from a gross margin perspective, we're going to have to continue to stay really disciplined on our pricing, Patrick mentioned that. We've got a good plan in place to start 2019 and we need to. We need to stay disciplined on this because the cost to find folks to screen them, the time that it takes in this low unemployment environment is more challenging than it has been in other periods. So we got to stay disciplined there starting first with our pricing. Our strategy here on getting more growth out of the small to medium-sized business part of PeopleReady will help from a mix perspective. Staying true on our – our competence here on workers' compensation is another focus for us there, an area where we've had really good, good progress over the last 15 years.

So our teams are still really heavily focused on that to make a difference in that going forward. From – if we take a step back and just take a look at the wage landscape here, I think we're going to be continuing to look for in our business needing to increase that bill rate by 5% to 6% to offset both minimum wage increases and just a continued shortage of workers out there. So I think for us though that's been something that we've been working on, it's been kind of in the wheelhouse really all year long. So going into 2019, I think the pages on our playbook largely remain the same. It's just a matter of us continuing to execute well on all of those items going into 2019.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.
Q

Great. And then with regards to PeopleScout good growth there. Can you talk a little bit more about the impact of TMP and particularly the International in terms of the RFP flow?

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.
A

Yeah, thanks Mark, this is Patrick. You know it's early days we made that acquisition in the summer earlier this year, but we're definitely seeing some progress. We had a multi-continent win that included both Europe and Asia.

Our pipeline is got a handful of deals right now that we otherwise wouldn't have had that are related to European scope. The other thing that we're seeing, Mark, is there's a talent advisory capability that we picked up as part of that TMP acquisition and we're seeing some deals in our pipeline right now that are in the U.S. for those talent advisory capabilities.

So we're reporting that, that capability over here to the U.S. which we really didn't have prior to the acquisition. So there is some good progress at this point with one what I would describe as a solid win and the talent advisory opportunity.

There's one other piece which is our U.S. clients that we have deep and wide relationships with. We're in conversations with them about their European scope where they – in cases where they have been outsourced already.

And so we've got a handful of deals from the existing client base as well. So, it's a nice mix of new logos, new capabilities with our existing clients and new geographies with our existing clients. Those three buckets are all populating our pipeline right now.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

Great. And then with regards to PeopleScout's segment margins, should we kind of use the Q3 number as kind of a baseline or how should we thing about that on a year-over-year basis, particularly as we go into next year?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah. Thanks for the question, Mark. I think it's a good one of course to have in the transcript for everybody to be reading here. I think the way – the best way to think about it is that with the acquisition of TMP that dilutes the overall PeopleScout margin roughly about 300 basis points. And let me provide some background on what's creating that dilution. So a part – a good chunk of TMP's business involves media-related spend on behalf of clients. So when I'm talking about media-related spend, I'm talking about recruitment, advertising, job boards, these types of things. So that cost is largely a pass-through cost. And so that pass-through cost is what creates a lower margin within that business compared to the legacy PeopleScout business. So I think if you were to take a look at any particular quarter that we didn't have TMP in it, you just roughly apply that 300 basis points of dilution as far as what your expectation would be in the new period with TMP and that should put you pretty close.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

Great. And then PeopleManagement, how should we think about that? It basically looks like the guide for Q4 even when we strip out Amazon's Canadian business and PlaneTechs seems a little bit softer than what you just did in Q3. How should we think about that or what's going on behind that?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah. Hi Mark, this is – it's Derrek here again. So with the PeopleManagement business we've just – we're just looking at a couple of customers that – where their production volumes are down a little bit. We're expecting them to be down a little bit here in the fourth quarter compared to fourth quarter a year ago. That's really it, not any customer losses that we're factoring in there. We're not seeing any slowing in the pipeline. Actually, the pipeline for both of the Staff Management and SIMOS businesses look pretty solid right now, more solid than we've seen them in the last couple of quarters. So with the exception of two or three client sites where we've got some production volumes that looked like they might taper down a little bit compared to Q4 of 2017. The rest of the business there looks pretty solid.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Great. And then just going back to PeopleReady, just general commentary with regards to verticals and regions and any impact from the – from the hurricanes recently?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah. So the – some of the best news at least from my perspective in our results is another quarter of growth of PeopleReady. They are stepping up a little bit and the broad-based nature of it. You know we had 16 out of our top 20 states at PeopleReady all putting up growth this quarter. By the way, those top 20 states represent about 75% of PeopleReady's revenue. We had a couple states in there that were – were negative, had more to do with one had a big minimum wage increase in it, one had the benefit in it actually from the hurricanes last year.

So, let's go to the other part of your question there just on the – on the hurricane benefit, Mark. The benefit actually is – is more of a headwind for us in Q3. So Harvey was a very, very big hurricane and that hit in the third quarter last year that we had some benefit of and a little bit going into the fourth quarter. The storms that we – the impact that came along this year, particularly Florence, didn't have nearly the same type of scale and was more really rural in nature, so impacted home owners proportionately larger than businesses in comparison with the storm we had a year ago

Probably get some lifts here for Michael in the fourth quarter, but we'll expect that to be kind of neutral with the Harvey impact that we had in the fourth quarter 2017. So, year-over-year basis, really not that significant for Q4 and then our growth rates for Q3 of this year about a point of headwind from storm benefit last year that didn't reoccur this year. Did I catch everything that was in your question?

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

Just about other than just the verticals like construction versus retail versus manufacturing, what are you seeing there?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah, I'm glad you asked that question. So, let's hit construction and manufacturing, because they're both the largest verticals for our business and particularly PeopleReady. So, let me give you construction and manufacturing. These two, by the way combined make up about 50% of total company revenue. So, construction for Q3 was down 1%, a slight – which was a slight improvement from the year-over-year decline in Q2, but a pretty sizable increase from where we finished Q1 at down minus 7%. Manufacturing was flat in Q3 and improvement from minus 3% in Q2 of this year which was a further improvement from minus 9% in Q1 of this year.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

Great. How about retail and hospitality?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yeah, well, let's just give them to you. Here's the rest of them. So, transportation was up mid-single digit, retail was down 5%, excluding Amazon, though it was up 8%. Hospitality was up mid-teens and that pretty much gives you all of them I think other than E&I...

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

That's great.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

...which you know it accounts our energy business.

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

And Mark, this is Patrick. I'd just add one thing, a couple of areas that we're seeing and the full time hiring that have picked up quite a bit. Manufacturing and hospitality both have been very strong performers in Q3 and year-to-date in PeopleScout.

Mark S. Marcon
Analyst, Robert W. Baird & Co., Inc.

Q

That's great to hear. Thank you.

Operator: Your next question comes from the line of John Healy of Northcoast Research. Please go ahead. Your line is open.

Kyle Patterson
Equity Research Associate, Northcoast Research

Q

Hi. Good afternoon, everyone. This is Kyle Patterson on for John Healy. And so I was just curious I know this was already briefly touched upon, but just wanted to get your perspective on any updated view that you have of the UK opportunity as a whole and just now that you've had some time to take a look at that business.

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

Well, from a U.K. perspective just to remind everyone that's relevant to our PeopleScout business. We don't have any staffing operations in the UK. So it's just PeopleScout and we look at the opportunities there. One of the things we talked about earlier is, yeah, there's a real opportunity for multi-continent RPO engagements. PeopleScout really didn't have a large presence in Europe prior to the TMP acquisition, so it puts us in the game to have a significant presence, because a lot of our clients ask us to tell us about your local presence, tell us about your referenceable clients in Europe and that's been a barrier for us in the last several years where it seems like we get to the finals in an opportunity and then we lose out because we just didn't have a big enough presence in Europe despite having a leading presence in North America. So, we're much more of a player now in any engagements that involve multiple continents.

The other piece, which I mentioned it also earlier, is around the talent advisory capabilities with TMP came a world-class talent advisory capability and employer branding capabilities and so we're using the capabilities that we acquired with TMP, across our entire install base globally. And so, that's creating some real lift for us in terms of the pipeline and I suspect we'll be closing some deals in Q4 and Q1, in North America with that talent advisory capability we've picked up in Europe. And then of course, bringing the PeopleScout brand and capabilities in the global recruiting footprint that we have, it also creates some tailwinds just for the UK and European operations that we have – have in large recruiting centers in Krakow, in Toronto, in Sydney and in India, all of those create capability that we can bring to TMP that wasn't there before, and so, that's another area of opportunity.

And so, we really like the acquisition that we made, the acquisition is on track. There haven't been any significant surprises at this point other than the pipeline is filled up a little faster than we might have thought. So, we feel pretty good about where things are at right now.

Kyle Patterson
Equity Research Associate, Northcoast Research

Q

Okay. And then since you guys touched on the M&A pipeline, just overall regarding capital allocation priorities. Is that the focus moving forward and even further into 2019, as you guys have been deleveraging the past few years, or with these few acquisitions we may be making over the next couple of quarters would it revert back to share buybacks and those type of shareholder returns?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

I'm glad you asked the question, so we can talk about that one a little bit. When – big picture-wise when you take a look at capital allocation for us now versus the most recent set of years, our growth strategies are more organically based now than they have been for quite some time and particularly really on the staffing side of the business. Patrick has talked about in his prepared comments the technology that we're putting in place and working with – with the PeopleReady. And so these transformations to make the – expand our digital footprint here both in the RPO side but particularly in the staffing side there is a fair amount of work with that and it's not all technology based.

So if you start adding in acquisitions on that that can be a distraction to the team and their focus on this digital transformation. Now on the RPO side, we have more interest in acquisitions there to the degree that they can help us win more global deals and TMP squarely fits into that. Customers, less acquisitions in the current geographies that we're looking that we're operating in maybe a little bit less down on the priority list from – from an acquisition perspective. And while we still think there is lot – there is room in the cycle and we're planning on growth for next year and I think we have lots of opportunities for it to grow and we are getting longer in the cycle. So the level of discipline and rigor that would go into an acquisition at this point in the cycle would certainly be heightened from where we might sit in the earlier phases of recovery.

So I think all that comes back around to say that the free cash flow that we have here there is going to be more and more of it available because of our organic focus on our growth strategies, which we plan to return back to shareholders through – through share repurchase. So you could very well see higher levels of share repurchase based on the availability that cash flow going forward since we would have less acquisitions at least from a historical comparison than we have in a while.

Kyle Patterson
Equity Research Associate, Northcoast Research

Q

Okay. Great. And then lastly, I was just curious if you could provide a little color on the cadence of business trends and how they fare throughout the third quarter and thus far into the fourth quarter?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Yes. Okay. So let's talk about that one. We got – we do have some noise in our numbers with the divestiture of PlaneTechs, the Amazon headwind that we have; storms-related information or storm-related year-over-year comps that we have. So, what I'm going to do is – if I exclude Amazon, the divesture of PlaneTechs, the TMP acquisition and any storm-related benefit or headwind, so I think that's really – what the intent of your question is to get to what the underlying growth trend is of the business. And by the way, this is how we look at as the management team. So I'm just going to give those to you. If we adjusted for those four items that I just mentioned, here is what our revenue trends were in the third quarter. July was up 5%, August was up 6% and September was up 4%, October was very consistent with September's exit rate. So, all in all, pretty consistent going in the fourth quarter from where we left off from in September.

Kyle Patterson
Equity Research Associate, Northcoast Research

Q

Okay. Great. Thanks for taking my questions guys and good luck through the rest of the year.

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

A

Thank you.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer, TrueBlue, Inc.

A

Thanks, Kyle.

Operator: There are no further questions at this time. I would like to turn the call over to Patrick Beharelle for closing remarks.

A. Patrick Beharelle
Director & Chief Executive Officer, TrueBlue, Inc.

Well, I just want to thank everyone for taking time out of your busy schedules to attend the call. We're working real hard to drive results, and we look forward to chat with you on the next earnings call. Thanks everybody.

Operator: This concludes today's conference call. You may now disconnect.