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TrueBlue, Inc. (TBI)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen. My name is Julie, and I will be your conference operator today. At this time, I would like to welcome everyone to the TrueBlue fourth quarter 2018 earnings 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]

And now, I would like to turn the call over to Derrek Gafford, CFO of TrueBlue. Please go ahead.

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

Good afternoon, everyone. And thank you for joining today's 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 risks 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 welcome everyone to today's call.

Before we dive into the quarterly results, I want to take a step back and reflect on 2018 in a broader sense and describe what we're focused on as we look toward the year ahead. Our 2018 results showed meaningful improvement in many parts of our business. And we also made substantial progress on several strategic initiatives. We returned PeopleReady to growth and delivered double-digit organic growth at PeopleScout. Our focus on lowering costs helped produce our third consecutive year of gross margin expansion, and we leveraged excess free cash flow to return $35 million to shareholders through share repurchases. We connected 730,000 people with work in 2018 and expect to take this number even higher in the future.

The success of our company will continue to be determined by our ability to adapt to the continuously changing world of work. Millennials are now the largest generation in the U.S. labor force. The ongoing retirement of baby boomers and the tightening labor market are creating widespread skill shortages and a greater need for just in time solutions. At the same time, our clients are becoming more strategic and thoughtful when planning their workforce needs, while our associates want greater flexibility and digital tools to manage their lives.

TrueBlue has been adapting our business to capitalize on these trends. The solutions offered to our clients by our three businesses run the spectrum from the assignment of one or two temporary workers to the placement of thousands in permanent jobs. In addition to offering solutions our clients need, we're also leveraging technology to make the entire process more efficient and user friendly. Our JobStack mobile app at PeopleReady and our Affinix platform at PeopleScout are transforming time-consuming manual processes into fast digital transactions and the improvements we are seeing demonstrate our enhanced competitive advantage.

In 2018, we dispatched 3 million shifts via JobStack and achieved our year-end goal to fill 35% of all orders digitally. 2018 was also the year we rolled out JobStack's client features, which allows clients to place orders and rate associates. By the end of 2018, we had more than 13,000 clients using the app, and worker adoption rates of 80% with 40,000 associates visiting JobStack every day. Thanks to the enthusiasm and support of our branch staff, clients and associates, we've achieved the scale we need to begin driving long-term competitive market advantages.

Looking forward, our focus for 2019 is on enhancing the JobStack user experience and leveraging the technology to capture incremental revenue. We will be scaling our digital marketing strategically to grow our associate base and attract clients previously outside our service network. We'll also be adding functionality to further enhance both client and associate retention. By leveraging JobStack to broaden our reach and increasing our digital fill rates, we plan to dispatch 4.5 million shifts via JobStack in 2019, which is a 50% increase year-over-year and equates to one worker dispatch every seven seconds.

Technology is also transforming how we do business at PeopleScout with the introduction of Affinix in 2018. Affinix is our industry-leading platform for sourcing, screening and delivering a permanent workforce. We're very excited about this proprietary technology and it has been generating a lot of buzz within the industry. We won several awards in 2018 including HRO Today's TekTonic Award for the Best Candidate Experience and the

Brandon Hall Award for Best Advance in RPO technology. But what's really exciting about Affinix is what it does for the business. As an example, before Affinix, we posted job and it could take up to five days to compile the first slate of candidates. With Affinix, we're using artificial intelligence and machine learning to crawl the web to source candidates and creating a slate of candidates within minutes. We're already seeing evidence of higher candidate conversion rates, reduced time to fill positions, and increased client satisfaction. We're just getting started with Affinix and we hope to have more to share as we move into 2019.

Another way we're adapting our business is through our PeopleScout global strategy. PeopleScout is both our highest margin and fastest growing segment, and its increasing importance to TrueBlue is undeniable. In 2015, PeopleScout represented just 5% of total company segment profits. But that number climbed to 31% in 2018. PeopleScout is now a truly global business serving clients in more than 70 countries.

In June, we announced the acquisition of TMP, a leading provider of RPO and recruitment marketing services in the United Kingdom. The acquisition of TMP creates opportunities for us across Europe and significantly enhances our ability to compete for multi-continent RPO business. Finally, our PeopleManagement brands continue to present opportunities. A few specific client headwinds hampered growth in 2018, but industry demand remains strong. And we continue to lead the industrial staffing market by offering sophisticated solutions to help our clients strategically leverage a contingent workforce. PeopleManagement offers a compelling range of services from traditional on-site staffing through our Staff Management SMX brand to value-added productivity solutions through SIMOS.

In March 2018, we sold PlaneTechs, which was formerly part of this segment. The divestiture will further enable us to focus on larger market, higher growth and higher profit margin opportunities going forward. As much as 2018 was a year of success, it was also a year of transition. I was given the honor of becoming CEO of TrueBlue in September taking the helm from Steve Cooper, who had been an executive at TrueBlue for nearly 20 years.

I'd like to thank Steve, the Board of Directors, and the entire executive team for all their efforts and assistance in planning and executing a smooth transition. The time I spent as Chief Operating Officer at TrueBlue was excellent preparation for the role, but it takes more than one person to run a company. And I'm very grateful and humbled by all the support I've received.

I'm excited about 2019 and the opportunities and prospects for TrueBlue. The accomplishments of the last year have given us much to build on. We have dynamic strategies that will help us propel our growth and enable us to meet the changing needs of the market. The world of work is rapidly changing. We have shown we can and will maintain market leadership with innovative technology, the right geographic reach and staying true to our purpose of connecting people and work.

Now turning to our Q4 performance. Our team delivered top line results that were in line with expectations, along with gross margin expansion and adjusted EPS growth. Earnings per share decreased by 8%, while adjusted earnings per share increased by 20%.

Let's take a closer look at the performance of each of our three businesses. PeopleReady is the leading provider of on-demand labor and skilled trades in the North American industrial staffing market. Our local relationships, nationwide footprint of physical branch locations, and growing use of technology help clients find contingent industrial labor quickly and efficiently. PeopleReady represents 61% of trailing 12 months total company revenue and 55% of combined segment profit. PeopleReady grew 2% in spite of energy headwinds, and we see the potential for further acceleration during Q1. We're pleased with the underlying growth trajectory of the business, with solid growth in local accounts, which increases our confidence in the sustainability of our growth.

PeopleManagement, our second largest business at 29% of revenue and 14% of combined segment profit, provides onsite workforce solutions in the North American industrial staffing market. Revenue growth was negative 18% or negative 4% when excluding the loss of the Amazon account in the third quarter and the PlaneTechs divestiture that was completed in the first quarter of last 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 cost 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 10% of revenue and 31% of combined segment profit given its attractive margin. Revenue grew 31%. Or excluding TMP, the UK-based RPO provider we acquired in June last year, organic revenue was up 6%.

Looking ahead, we do expect some near-term headwinds. We brought on 25 new logos in 2018, similar to 2017. But these new logos have not been growing in scope as quickly as we'd like. And we also have some specific client profitability headwinds that Derrek will discuss momentarily. In spite of these near-term challenges, we are excited about the continued growth prospects for PeopleScout as we further differentiate our service through Affinix, our proprietary talent acquisition technology, and as we leverage the recent TMP acquisition.

With that, I'll hand the call over to Derrek to walk us through our financial results in greater detail.

Derrek L. Gafford

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

Thank you, Patrick.

Total revenue of $650 million was right in line with our outlook of $640 million to $659 million. As expected, the revenue trend stepped down to a decline of 3% versus the same period last year in comparison with growth of 3% in the third quarter versus last year. The previously disclosed decision by Amazon to insource their Canadian labor needs accounts for 3 points of the step down.

The PeopleManagement business produced an additional point of step down from less same-customer revenue. PeopleScout produced a point of step down from a normal seasonal step down in the acquired TMP business and a lower organic growth rate. And lastly, the PeopleReady business experienced a quarterly peak in its energy business in Q4 2017, which contributed the last point of step down.

Net income per diluted share was $0.37 and adjusted net income per diluted share was $0.61, which was near the high end of our $0.55 to $0.62 expectation, driven by strong gross margin performance and a lower effective income tax rate. Adjusted net income per share increased by $0.10 or 20%, primarily due to a lower effective income tax rate.

The effective income tax rate for the quarter was in line with our expectation at 16%. For fiscal 2018, our effective income tax rate was 13%, lower than our 16% expectation as a result of higher Work Opportunity Tax Credits. Looking forward, we expect an effective income tax rate of about 14%. We used this rate in our calculation of adjusted net income for the fourth quarter and expect to do the same in 2019.

Gross margin of 26.5% was up about 150 basis points, representing our 12th consecutive quarter of expansion. The improvement in gross margin was driven primarily by lower workers' compensation expense, lower payroll taxes, and the addition of higher-margin business at PeopleScout.

SG&A expense was up $13 million, with $5 million of the increase from adjusted EBITDA add-backs, $3 million from the net impact of acquisitions and divestitures, and the remainder from core operations. Adjusted EBITDA was down 8% and related margin was down 30 basis points.

Turning to our segments, PeopleReady revenue grew by 2%. The energy business experienced a quarterly peak in Q4 2017, creating 2 percentage points of headwind in the fourth quarter, which is 1 percentage point higher than the headwind faced in Q3 2018. Now that we have anniversaried this item, we expect revenue growth to accelerate in the first quarter.

Revenue growth trends in Q4 were largely consistent with Q3 this year, with growth coming from most of the geographies and industries served. One standout is our small to medium-sized customer business, which makes up 65% of the business. Growth accelerated to 6% in Q4 versus 3% in Q3 and 1% in Q2. Small business optimism in the U.S. continues to trend at record highs, which when combined with the small amount of slack in their workforces bodes well for staffing providers focused on this market. Segment profit was up 4% and segment profit margin was up 10 basis points.

PeopleManagement revenue growth was down 18%, or after excluding the Amazon account and PlaneTechs divestiture, was down 4%. Segment profit was down 40%, which includes 32 percentage points of headwind from the divestiture of PlaneTechs and the Amazon account.

PeopleScout revenue was up 31% or 6% on an organic basis. Segment profit was up 14%, and segment profit margin was down 280 basis points due to the acquisition of TMP in June. As we've mentioned in recent quarters, TMP purchases recruitment media on behalf of certain clients, and the pass-through nature of these costs creates margin dilution. Excluding TMP, segment profit margin was up 20 basis points.

Year-to-date cash flow from operations totaled $126 million and capital expenditures were $17 million, netting to free cash flow of $109 million. Cash flow from operations was boosted by a two-day improvement in day sales outstanding in the fourth quarter.

Our balance sheet continues to improve. Total debt of $80 million is down from $119 million at the beginning of the year, and our debt to total capital ratio was 12%, compared to 18% at the beginning of the year. On a trailing 12-month basis, our total debt to adjusted EBITDA multiple stands at 0.6, compared to 1.0 at the beginning of the year. Returning capital to boost shareholder returns is an important part of our strategy, $10 million of stock was repurchased in the fourth quarter and repurchases for the year totaled $35 million, representing one-third of free cash flow for the year.

Let's turn to our outlook for Q1. The big picture is we expect to see an acceleration in demand for PeopleReady, but expect a combination of revenue and pricing headwinds for PeopleManagement and PeopleScout. Since Q1 is our lowest volume quarter, these headwinds have a more pronounced impact on year-over-year profitability trends. To enhance transparency, we are also providing segment profit outlooks this quarter in addition to our consolidated outlook. As a reminder, segment profit is equivalent to adjusted EBITDA.

Now, let me show you the numbers in our consolidated outlook for the first quarter. We expect revenue to be flat to growth of 3% and expect net income per share of $0.07 to $0.11 or $0.22 to $0.27 on an adjusted basis, which assumes a share count of about 40 million and an effective income tax rate of 14%. We expect adjusted EBITDA of $15 million to $17 million, which using the midpoint of this range represents a decline of about $3 million or $4 million excluding TMP.

I want to provide some color on the adjusted EBITDA decline by talking through the segment profit outlooks. For simplicity, I'm going to speak to the midpoint of the range for each segment, but this should not be misconstrued as an implication of precision or certainty. At PeopleScout, excluding TMP, we expect $3 million of segment profit headwind in Q1, $1 million of the headwind is tied to a drop in volume and price with a certain client. As is the case with many of our clients, this account started as a project with project-based pricing and grew rapidly.

This client is expecting less hiring volume in their business this year, and we've reduced the price in exchange for a multi-year arrangement. Also, there is $1 million of headwind from a client that was lost after being acquired. We expect about $9 million of headwind beyond Q1 this year for these two clients, which is $11 million of total headwind for the year. Lastly, we expect $1 million of headwind in Q1 from a hiring surge experienced by one of our clients in Q1 last year, but we do not expect additional headwind for this customer beyond Q1.

At PeopleManagement, we expect $3 million of headwind in the first quarter split between Amazon and another retail client related to less volume and movement of the account from our SIMOS business to our Staff Management business, which carries a lower segment profit margin. Beyond Q1, we expect an additional headwind of $4 million for the year, which is $7 million of total headwind for the year.

Moving to PeopleReady and corporate costs, we expect about $2 million of tailwind. We expect revenue growth in Q1 to accelerate to about 4% versus growth of 2% in Q4 of 2018. Please see our earnings release deck filed today for additional details on the first quarter outlook. While there are some near-term challenges, the value propositions, business models and strategies of our segments are sound. Despite the near-term headwinds, we are planning the business for growth in 2019.

Let me share a little on our perspective beyond the near term. Annual growth of the RPO market is expected to be 12% for the foreseeable future, and PeopleScout is a well-recognized leader. However, the timing of growth can be lumpy. For example, in the second quarter of 2017, organic revenue was down 1%, but rallied to grow 22% within three quarters. We're in the right market, have the right know-how, and we believe our investments in Affinix will further differentiate this business and continue the strong growth track record of this high margin business.

Our PeopleManagement segment, which is our lowest margin business, differentiates itself without branches providing a very efficient delivery model for large customers through a traditional bill rate offering and a productivity-based outsourcing offering. While it has a proven business model, the mix of U.S. job growth is increasingly coming from small businesses, which may require market share expansion on our part to drive growth under these conditions.

We are optimistic about PeopleReady, our largest segment, which also has the strongest operating leverage. A variety of improvements are powering the acceleration in top line growth including a flatter and more defined organizational structure, various leadership changes and more robust sales strategies with a particular focus on small- and medium-sized businesses. This segment has a deep knowledge of the complexities of on-demand labor and skilled trades, has the right focus and with JobStack continues to differentiate itself. Lastly, we remain committed to returning capital through share repurchase to boost shareholder returns. With strong cash flow and a balance sheet that continues to improve, we see opportunity to return more capital in the future.

With that, operator, please open the call now for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Kevin McVeigh with Credit Suisse. Please go ahead. Your line is open.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC
Q

Great. Thank you. Hey, I just want to start with Patrick. Again congratulations. I just wonder if you could give us some thoughts as you kind of reflect on your first year in the seat and kind of upside, downside, any kind of thoughts on the business at a higher level.

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

Yeah. Thanks, Kevin. I appreciate the question.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC
Q

Sure.

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

In terms of upside, one of the areas we're most bullish on is PeopleReady and JobStack. We're starting to see the early stages of value creation in JobStack. We've put some numbers out there in Q4, where we've got over 13,000 clients that are now using JobStack. And in December, we had 38% of our positions that were filled digitally, 35% for the quarter.

And one of the things that we're most encouraged by is we've noticed that when clients that we've been working with for multiple quarters get signed up on the JobStack, we're seeing pretty healthy increases in wallet share. In fact, we're seeing double-digit increases in those clients from a pre-JobStack position to a post-JobStack position. So we're really bullish on JobStack right now.

Long term, we're very bullish on PeopleScout. It's, as Derrek mentioned in his remarks, a high-growth industry, a high-margin business, and we think we've carved out a leadership position. We've got technology that we've rolled out called Affinix that we're very bullish on. And when we talk with clients and prospects and see the results that are happening with Affinix, we're pretty excited about that.

In terms of areas of concern, it's mostly in the near term. If you look at our results in Q4, pretty solid. But you look at our outlook for Q1 and we've got some headwinds, and they're mostly client-specific headwinds. I wouldn't say that we've got issues with the underlying business, but we've got some lumpiness in terms of PeopleScout and PeopleManagement and a couple of specific clients that are moving in the wrong direction from a revenue and EBITDA perspective. So that's my area of concern is more in the near term with PeopleScout and PeopleManagement, and then very bullish long term on PeopleReady and PeopleScout.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then just following up on that, Patrick, the order fill in terms of 35% electronically, how should we think about that in terms of leverage to the model, because obviously it's got to be a much more efficient fill process than the historical way? Is there any way to think about at certain points of fill, we could expect some type of margin accretion associated with that?

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

A

Kevin, long term, the answer is yes. In the near term, we're primarily focused on revenue growth through JobStack, specifically, going out and getting more clients than we otherwise would have gotten, retaining more clients than we otherwise would have retained, getting scope expansions like I mentioned earlier and more wallet share with our clients, some pricing premium through a premium-based delivery model. And I think longer term down the road, our dependence on a brick-and-mortar cost structure is going to reduce. But it doesn't necessarily reduce when you're at 35% or 40% of your fills digitally. That starts to reduce when you get north of 50%. And so I think that's more of a longer-term play on the cost side, and the near-term play is more on the revenue side.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And then just if I heard you right, it sounded like there's about $11 million in total headwind from those two clients of PeopleScout. Can you help us understand that a little bit more? And again, it seems like you folks have been prone from time to time to some client concentration. Just any thoughts on that. And is that something you look to maybe try to address in the future so you don't have these type of lumpiness, if you would?

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

A

I'll comment on each of them, because there's a different story on each one. So the first one, we're just on the wrong side of an acquisition. These things happen from time to time. In fact, about 18 months ago we were on the right side of an acquisition of a big hotel chain that led to a multi-million dollar expansion. In this case, we were on the wrong side of it. The acquiring company had an in-house model. Our client had an outsourced model to PeopleScout, and a decision was made to go with an in-house model. And so we found out about that recently. So this wasn't a performance issue, it was just being on the wrong side of an acquisition, and the client decided they wanted to have one model and it was the model that the acquiring company had.

In the other case, this is a situation where we sold a project right at the end of 2017, and it was originally a small scope deal with a lot of project-based work. And then throughout 2018, we did a great job for that client, and scope was expanded in a very significant way. And we still have that project-based pricing that was in effect throughout 2018. And so both the client and us agreed that it made sense to have more of a multiyear partnership together. And so we adjusted our pricing to reflect that reality.

The numbers we've put out there don't include any project-based work that we don't have visibility to. So what we're seeing here is a pricing adjustment coupled with an expectation that some of the project work that we did for this client won't repeat in 2019. This is still one of our largest clients, by the way, of PeopleScout. It's just not going to be as large as it was in 2018.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay, that's helpful. And then are you seeing any initial impact from Brexit?

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

A

We haven't seen anything show up in our numbers related to Brexit. So to answer to your question, no, not really.

Kevin McVeigh
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay, great. Thank you so much.

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

A

Thank you.

Operator: John Healy with Northcoast Research, please go ahead. Your line is open.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Hi. Thank you, and congrats on a strong year, guys. I wanted to ask about the PeopleReady business, the 2% growth rate in the quarter and the outlook for 3% to 5%. Can you maybe give us a little bit of more framework about what drives the confidence in the acceleration there? Is it market driven, is it kind of the initiatives that you guys are working on? And then, maybe some context about maybe how January performed and if you guys have anything just about bill rates in that versus hours in that business?

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

A

Sure thing. Hey, John, it's Derrek here. So, in regard to the first part of the question, the outlook for PeopleReady, what gives us the confidence is the underlying trend in PeopleReady is really already running at that rate. So, while PeopleReady grew at the 2% on the face of the financials that we shared with you today, it's hampered a bit by our peak energy that we had in that business in Q4 of 2017. So, if you take that headwind out, PeopleReady was growing at 4% for the quarter. And so as we turn into 2019, we don't have that same energy comp. And that's what gives us primarily the confidence there.

The other thing behind the scenes that's been a building aspect of confidence really throughout the year is where the growth is coming from. It's not coming predominantly from large customers; it's coming from our small- to medium-sized customer business, which makes up about two-thirds of that business. That business grew at 6% in the fourth quarter, which is up considerably from about 3% in the third quarter growth. If we went back to second quarter, it'd be at 1%, and even further back it'd be negative. So, it's been on a really nice trajectory. So, the composition of the growth, the widespread nature of it gives us confidence as well.

Going into your last part of your question about how January turned out. January was towards the lower end of our revenue range here, but we've had some weather headwind, the last three weeks have been tough in respects to PeopleReady. So, we're pretty confident though that when the weather passes, we'll get back into that same run rate of growth that we were at in the fourth quarter.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Great. And then I wanted to ask just about the benefits of the JobStack application, and I know you guys mentioned that it sounds like it's more of a revenue upside or a tailwind this year. But if I just think about the comment you made about getting to 4.5 million of shifts this year versus the 3 million last year. I mean, to Patrick's point earlier that would imply that over – right around 50% of the shifts will be billed with the app, which to me means that maybe you're not that far off from thinking about aspects of the physical branch network. So, I was just hoping you guys could maybe size, give some thoughts, color about how that physical branch footprint might transform maybe over the next two or three years?

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

A

Thanks for that, John. In terms of how it's going to transform, there's two aspects to it. The first is we've got a group of folks that work in those branches that prior to JobStack were spending a good bit of their time doing match and dispatch type activities. One of the things that we're doing is we're reorienting those roles within the branches to be more focused on revenue generation, and so we're taking that time that has been freed up within those branches reallocating the time to going out and visiting more clients and trying to expand scope. Going out and visiting more prospects and trying to win their business. Spending more time on client service type issues. So, in a lot of these branches, we have three or four people. So, it's tough to cut out half of a person or three-fourths of a person.

And so initially what we're focused on is having those folks going out, being retrained, reoriented in terms of their compensation plans and having them focus on the activities that I just described that are primarily revenue generation. There will come a point though where we reach a critical mass where there could be some consolidation of branches or consolidation of roles within those branches, and what I'm just suggesting is it's down – that's more of a down the road focus that the initial focus is taking those folks that we have in those branches, making sure we've got the right skills there and focusing them on higher value-add activities as opposed to lower value-add activities like match and dispatch.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Got you, that's helpful. And then, just one question for Derrek on capital allocation. I think in the last two years, about 30%, 40% of the free cash flow has gone up to share repurchases. Without any sizable acquisitions coming your way, do you – would you expect that kind of returning a capital to shareholders to be pretty consistent in 2019?

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

A

Hi, John. Yeah. Thanks for the question. Yeah. If we take a look at the balance sheet, it continues to get stronger and with the free cash flow that we've got, we want to put that to work. So, we did not want to build up a lot of slack in the balance sheet here. And as you mentioned, with more and more of our growth strategies pointing really towards organic growth versus our history, you're not going to have the acquisitions as much in there. So, yeah, we're planning on continuing to allocate a significant portion of the free cash flow back to shareholders. We want to be active to a certain extent each quarter, and then, we also want to have some capacity to be opportunistic in the stock price as well.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Great. Thank you, guys.

Operator: Mark Marcon with our 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, if you could talk a little bit more about JobStack. I just want to make sure I understand the dispatches and some of the stats that you were giving. It sounded really interesting. So, can you talk a little bit more about how we should – is a dispatch actually somebody actually being dispatched and actually filling a position for a full shift?

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

A

Yeah. Thanks, Mark. The answer is yes to that question. And then, I think it might be helpful maybe to share a story with you, and then give a little more color on some of the stats that I quoted earlier. So, I'll give you an example. We have a client, it's a logistics provider in Massachusetts and they need warehouse pickers and packers. And so, we had went out on a sales call and they said we're going to need two people over the next week or so. And so, we saw that they were having some trouble with their existing providers and we went ahead and filled those two positions.

And we showed them JobStack and sort of walked them through the sort of 24/7 nature and how they could geolocate workers and how they could improve time electronically and rate those workers. And they said, we're going to stress test this, we're going to send you an order for 40. And we filled 30 of them within the first day and filled the other 10 shortly thereafter. And we did such a great job on those 40, they said, tell you what, we're going to give you all of our business. And so, next thing you know, we had 75 people that were on billing at this particular client. So, it was a takeaway from our competitors. And that's not an uncommon thing that we're seeing right now with our clients.

I quoted a statistic earlier that when we take an existing client that we've been doing business with in a manual brick and mortar way, and then sign them up on JobStack and they start placing orders on JobStack, we're seen a spike in volume coming from them within the first quarter since they've been signed up on JobStack. And so, that's leading to more business, more positions filled and hence more revenue. And some we're pretty excited about because there're some areas related to JobStack that are difficult to measure. An example would be new client acquisition. It's hard to know whether we'd have won that client because of JobStack or we'd have won them anyway. But what's not difficult to measure is when we have a pre-JobStack number and a post-JobStack number across a large statistically significant number of clients. That gives us a lot of confidence and we're feeling very bullish right now on the digital capabilities that we have.

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

Q

That's great. And then, as we think about the some of the branches that have adopted more willingly and more optimized, what percentage of the fills are now coming through JobStack and stay your top 100 branches?

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

A

We're over 50% in 200 branches right now, and we're over 65% in sort of that top decile.

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

Q

Great. And you've mentioned, you're going to take some steps to optimize it further. What are the things that you're looking to do?

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

A

Well, we're adding some functionality in a couple of different areas. One is, some positions previously couldn't go on JobStack, because they required certifications or specific experience that we didn't necessarily have fields for. And so, we've been adding fields and then gathering that information on all of our workforce. And then, that allows us to digitalize or add more positions to JobStack, because if we don't, we have to know which people have which certifications to be able to match them to the positions electronically. So, that's one change.

The other thing we've been doing is putting in place referral capabilities both for clients and for workers, where they can easily refer the tool to their colleagues, to their friends, and to others, and we've seen some pretty good lift for where we've been piloting that. So just every day that goes out, or every day that happens, we're putting more and more functionality into the tool. We're going to continue that through 2019.

And we put some numbers out there that we think we're going to get to north of 4.5 million positions that will be filled through the tool. I think we're going to get north of 50% in terms of the number of jobs that are being filled digitally. And when that happens, that gives us a lots of options in terms of what we can do on the cost side. It's just hard to do it from a cost perspective when you've got a subset of your positions in a third or so of your positions. When you start getting north of 50%, 60%, 70%, that just creates a lot more optionality for us.

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

Q

Great. And then can you talk a little bit about – you mentioned you're seeing really good success with the small businesses. If you just go through the math and just do a weighted average, there's an implication with regards to the non-small and medium-sized businesses. Is that just because of the headwinds that are previously mentioned, or are there other medium and large businesses that are contracting?

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

A

Hi, Mark. It's Derrek here. Some of that has to do with the energy business headwind that we've had. And then, with larger customers we've seen a slower pace. There are not anything significant – any significant standouts like we've called out for the other segments with PeopleReady necessarily. But we have seen a slower pace with larger customers, similar to what we've seen over on our PeopleManagement side.

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

Q

Okay. And could you talk a little bit about that on the PeopleManagement side, just the client that switched over from SIMOS over to regular PeopleManagement? Why was that?

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

A

So this is a big company in the retail space, and they had a change in leadership. So this was a very large client for the SIMOS business. And with that change in leadership, they came to us and said hey, we want to have more control over our contingent labor force. With the SIMOS model, there's a lot more control, a lot more responsibility, and quite frankly higher margins for us in that business. And so they said, we want to have more control. And so what they did is, they actually put an RFP out and ran an RFP process, and said look, we want to have just a traditional onsite staffing model, and so Staff Management competed in that RFP and won that business. But a traditional staffing model carries quite a bit lower margin than the SIMOS model, which is a more sophisticated, more engineered type solution that involves more risk. And so we're taking a pretty significant margin haircut on that particular client.

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

Q

All right. So there was new leadership that came in and they just had different ideas.

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

A

Yeah.

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

Q

With regards to PeopleScout, Affinix sounds really good. What percentage of your clients on PeopleScout are using it?

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

A

We're just getting started on Affinix. We've got 16 clients today that we would describe as full on Affinix, and we've got 69 clients that are using pieces of Affinix. And so what we're excited about is, we're really just scratching the surface right now, I want to say.

So I'll just give you an example. We sold a pretty significant deal in the fourth quarter, and we brought this client onto Affinix. And their application process used to take 30 minutes just in terms of the initial application. Today that takes 8 minutes. The time to fill on these particular positions has been cut by eight days.

And here's the most interesting statistic of them all, Mark, which is previous to Affinix, this particular client was seeing somewhere between 25% and 30% of the people who started the application actually converting in the process and getting all the way through the application and moving forward to the next step, so they had a dropout rate of 70% – 75%. Today that dropout rate is down to less than 20% now, so over 80% of the clients are getting through the process. And so what that means is in a tight labor market like this, a lot more supply for that particular client because we've streamlined the application process and haven't compromised quality at all.

The other thing that we're seeing and the reason the time to fill is collapsing is in the example I gave in my prepared remarks about how we're using artificial intelligence to go out as soon as reqs are opened and have a pool of candidates in a recruiter's inbox that's scored, stack ranked in literally in a matter of minutes. And so, it's a really powerful tool. And what I think the biggest implication for – in Affinix is going to be long term is I think we're going to win a lot more deals than we otherwise would have won.

I sit in a lot of these sales calls with prospects and what they tell us is the tool is the best they've seen. And folks that have looked at this externally, we won some awards in the back half of 2018, the TekTonic Award and the Brandon Hall award. So, people that are sort of independently looking at this tool or saying, Wow! It's got some Wow! factor to it. And it's not just sizzle, there's a lot of steak there. So, we're pretty excited about Affinix is going to do long term, but we're just getting started is the headline there. We haven't really seen near the upside that we're going to when we get all of our clients on the tool.

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

Q

Okay. Sounds really good. Just I'm wondering, Derrek, just to be clear with regards to page 12 of the slide deck. Just if I'm interpreting it correctly, I mean basically the biggest headwinds from a profit perspective actually occurs in the third quarter. Is that the right way to interpret the slide deck?

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

A

For PeopleScout or in total?

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

Q

In total, so basically putting PeopleScout and PeopleManagement together.

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

A

Well, yeah, it's – that would be the biggest. It's pretty close with where we are. So in the first quarter, yeah, we've got $3 million from PeopleManagement, $1.8 million from PeopleScout. So, a total of $4.8 million. And then, as you even pointed out, it hits a peak in the third quarter at – if you add the two numbers together at $5.6 million. So, that's right.

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

Q

Okay. And that's just purely from a comparison perspective. So, some of those lost clients basically, they peaked basically in the third quarter on the PeopleScout side?

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

A

That's right.

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

Q

Okay.

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

A

Just to clarify though. Only one of them is lost. The other is still a very, very large client force.

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

Q

Got it. Thanks for the clarification. Thanks for all the comments. Appreciate it.

Operator: We have reached the end of our question-and-answer session. I will now turn the call back over to Patrick.

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

Thank you. I don't have anything to add, operator. Appreciate everyone taking time to listen in on the call, and looking forward to some good results here in Q1.

Operator: This concludes today's conference call. Thank you for your participation, and you may now disconnect.