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TBI - Q2 2014 TrueBlue Inc Earnings Call

EVENT DATE/TIME: JULY 24, 2014 / 1:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2014 TrueBlue earnings conference call. My name is Steve and I will be your operator for today. (Operator Instructions) As a reminder, this call is being recorded for replay purposes.

Now I would like to turn the call over to Stacey Burke for the Safe Harbor speech. Please proceed.

Stacey Burke - *TrueBlue, Inc. - VP Corporate Communications*

Thank you and welcome. We appreciate everyone joining us for our call today. Please note that on this conference call, management will reiterate forward-looking statements contained in today's press release, and may make or refer to additional forward-looking statements relating to the Company's financial results and operations in the future.

Although we believe the expectations reflected in these statements are reasonable, actual results may be materially different from the forward-looking statements set forth in today's press release and presentation slides, which were filed in an 8-K today. Examples of factors which could cause results to differ materially can also be found in our most recent filings with the Securities and Exchange Commission.

The discussion today also contains certain non-GAAP financial measures. Information relating to comparable GAAP financial measures may be found in the press release and presentation slides, which are posted on our website at www.trueblue.com. We encourage you to review that information in conjunction with today's discussion.

On this call today is TrueBlue's CEO and President, Steve Cooper, and CFO Derrek Gafford. I'll now turn the call over to TrueBlue's CEO, Steve Cooper.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Thank you, Stacey. Good morning, everyone. Today we reported 2014 second-quarter revenue grew 7% to $453 million, which produced $25 million of adjusted EBITDA and $0.39 of net income per share, which was in the midpoint of our previously disclosed expectations when all one-time costs and timing differences are taken into consideration.

Our second quarter was impacted by many items which we will discuss with you here today, to give you further light on our fundamental trends and results which continue to improve. There are 5 items I want to call to your attention here today.

First, our revenue growth trend from both our organic business and our acquired business from prior year continue to perform well, given the impact of the Q1-related negative to GDP and the severe weather we experienced.

As the second quarter matured, our trends continued to improve and the momentum we saw in June and continue to see here in July is stable and improving slightly.

Second, our gross margins our gross margins have held consistent with prior year which is a fantastic result, given there have been continued regulatory cost increases this year such as minimum wages. We have continued to be successful in passing through these types of cost increases and maintaining our gross margins.

Third, our operating expenses have been impacted by certain acquisition-related expenses, some of which are classified as non-recurring. We have had other costs in Q2 and some forecasted for Q3 related to the acquisitions and other items.

Derrek will reconcile the larger items for you later on this call.

My main point is to emphasize that we remain committed to our core operating expenses. They will remain in line with our previous expectations, and that we continue to see the ability to leverage our fixed cost structure to improve our operating leverage going forward.

Fourth, we had a positive impact from the Worker Opportunity Tax Credits associated with our 2013 and earlier years by putting certain qualified people to work, including veterans. We have increased our focus in this area and are proud of the impact we are having in the lives of those people we were able to help get back to work.

As a result, our qualified workers have increased by over 25%, which has driven the one-time benefit in the tax credits this quarter. Great execution by all of our teams.

Fifth, we are particularly excited about our recent acquisition of Seaton. We announced the deal on June 2nd and then followed up on June 30 to disclose it closed the first day of the new quarter here in Q3.

Our Q3 forecasts will be important to understand, as we now have three weeks under our belt and we have better insight as to both the short-term and the longer-term impact as a result of this transaction. It has been a busy quarter for us, and the third quarter remains just as exciting.

Bringing the leadership teams together quickly from the newly acquired businesses with our existing leadership team has jump-started the process of offering a broader range of solutions to all of our customers.

In addition to the temporary staffing services we have traditionally provided, we can now do more for our customers through sourcing, screening, and onboarding their on-premise temporary workforce and their permanent employees.

Before I hand the call over to Derrek to discuss some of these details with you further, let me say a couple of things about our continued momentum. We remain enthused with the organic growth opportunities in our business. We are in the right service lines that are showing demand. We are focused on a broader spectrum of capabilities for our customers, and we have the opportunity to improve our growth rates even further from here.

From general labor to skilled construction to workforce management and recruiting full-time positions, we find ourselves well-positioned in sectors that are growing.

We are also encouraged that our EBITDA margins continue to expand from here. Our goal to surpass 6% EBITDA margins and beyond is well within reach.

Let me turn the call over to Derrek, and then I will take a few minutes to discuss our current strategies and structure in place to execute them. Derrek.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Thanks, Steve. I will start off today with a high-level overview of our results this quarter. Then we will drop into a deeper discussion of our business results, the Seaton acquisition, and future expectations.

Earnings per share of $0.39 was $0.15 above our midpoint expectation of $0.24. Lower income taxes contributed $0.12 of the difference, and lower nonrecurring acquisition costs contributed $0.03. In my commentary, any reference to our performance is based on a comparison to the same period a year ago unless stated otherwise.

I will be discussing adjusted EBITDA, which excludes nonrecurring acquisition and integration costs. We use this measurement within our business and believe it provides additional perspective useful to shareholders.

Now let's take a deeper look at this quarter's results, starting with revenue. Total revenue growth this quarter was 7%, as expected in the guidance issued June 2nd. Organic revenue contributed three points of growth, and the Q4 2013 TWC acquisition contributed 4 points. Monthly organic revenue trends were as follows: April 2%, May 3%, and June 3%.

Now let's cover gross margin and SG&A expense. Gross margin for the quarter came in as expected at 26.4%, resulting in gross margin being roughly equal to Q2 a year ago. SG&A expense of $96 million was $1 million less than expected, largely due to lower nonrecurring acquisition costs due to the acquisition of Seaton, which was completed on the first day of our third quarter.

Compared to Q2 last year, SG&A was $7 million higher due to the following items: $3 million of ongoing operating costs from the TWC acquisition; $2.5 million of unique administrative costs, the largest being fees associated with the income tax benefit discussed earlier; and $1.5 million of costs to support the growth of the business.

We also incurred $2 million of nonrecurring costs related to the Seaton transaction this quarter, which is equivalent to the $2 million of integration costs incurred Q2 last year on the MDT transaction.

Adjusted EBITDA of $25 million yielded a 5.6% margin for the quarter. Excluding the $2.5 million of unique administrative costs mentioned earlier, adjusted EBITDA would have been 6.1% or 30 basis points above Q2 last year.

Our effective income tax rate was lower than expected, due to $5 million of income tax benefit related to the Worker Opportunity Tax Credit. While this program has not yet been renewed for 2014, benefits for prior-year programs are coming in more than expected. An increase in the average credit, driven by elevated qualification rates and a larger mix of higher-credit workers such as veterans, produced the benefit.

Now I will provide a recap of the recent acquisition of Seaton. We purchased Seaton, which we now call Outsourcing Solutions, for $310 million. The transaction was funded with about $120 million of cash and $190 million of debt through a $300 million revolving credit facility, which replaced our former facility. It is an asset-backed covenant-light facility with a 5-year term and a current interest rate of 2%.

Looking forward to the 12 months following the close of the transaction, estimated results for Outsourcing Solutions are as follows: $730 million to $750 million of revenue and $35 million to $39 million of adjusted EBITDA, $5 million of nonrecurring costs, $4 million of depreciation, and $12 million of intangible asset amortization. The valuation of intangible assets is still in progress and should be completed during the third quarter. And last, capital expenditures of about $6 million.

In addition to the strategic and operational value that this transaction provides, which Steve will discuss later on the call, we are excited about the immediate shareholder value this transaction brings on two levels. First is effective use of capital. TrueBlue's return on equity for 2013 was 13%. Assuming we purchased Seaton at the beginning of 2013, pro forma return on equity would have increased to 16%, excluding Seaton amortization.

Second is the strong earnings accretion it is expected to deliver. For the forward 12-month period, the transaction should add about $0.25 to earnings per share or about $0.45 excluding Seaton amortization.

Now let's cover expectations for the third quarter. Earnings per share should be $0.38 to $0.46, total revenue of $634 million to $647 million, or total growth of about 42% which includes the following assumptions: Staffing solutions revenue of $485 million to $495 million, which includes a 4% organic growth rate assumption; and outsourcing solutions revenue of $147 million to $152 million.

Total adjusted EBITDA should be $40 million to $45 million which includes the following assumptions: Staffing solutions adjusted EBITDA of $36 million to $38 million, and Outsourcing Solutions adjusted EBITDA of $5 million to $6 million.

Here is a little more color on consolidated assumptions. Gross margin should be 24.5% to 24.9%. SG&A will include about $3.5 million of nonrecurring acquisition and integration costs related to the Seaton transaction. And our effective income tax rate should be about 40%.

Now I would like to give some important background to better understand the strong leverage expected in the third quarter from our legacy business. While the annual adjusted EBITDA margin for the new Outsourcing Solutions group is the same as Staffing Solutions, the seasonality is different.

Outsourcing's seasonality peaks in the fourth quarter, producing nearly half its annual adjusted EBITDA, versus Staffing that peaks in the third quarter, producing about 40% of its annual adjusted EBITDA. Excluding the Seaton business results from Q3 2014, pro forma adjusted EBITDA margin in our legacy business is expected to expand by about 30 basis points.

We are pleased with the operating leverage our business continues to deliver. We are also excited about the opportunities to continue our track record with expanding use of technology in our processes, further reducing our branch footprint, and acquiring businesses related to current service offerings as well as complementary offerings.

Additional information on our strategies, performance, and expectations for Outsourcing Solutions can be found in the earnings release presentation and Q3 2014 investor presentation filed today.

I will now turn the call back to Steve.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Thank you, Derrek. I appreciate that analysis and commentary. The key to success for us is to ensure our growth efforts continue to remain focused on specialization in regards to our customers' businesses. We have found that customers want a specialist out there serving them. At the same time they expect those specialized services are easy to access.

This is where we have excelled, being structured in a manner so that it is easy for our customers to access our specialized services. Our focus in these important areas sets us apart from the competition.

For our shareholders, they have an easy-to-understand investment that is focused on high-demand jobs with a specialized approach to customer service and candidate recruiting. This has proven to result in both strong growth and margin stability for us while we continue to focus on what's important for customers; that is stabilizing their own cost structuring and their own operating structure.

We understand the importance of maintaining strong gross margins that reflect the specialization we bring to the marketplace, and we are pleased with our progress here in 2014. We believe we are well-prepared to handle further minimum wage increases and The Affordable Care Act costs that will go into effect over the next year.

Just as we have shown great results again here in the first half of 2014, in absorbing and properly pricing employment cost increases, we feel we can continue this trend. The addition of the newly-acquired service lines will quicken our pace in expanding our service offerings to our current customers, along with the acquired customers that need expanded services from our existing capabilities.

TrueBlue is now the largest industrial staffing provider in the US. Our combined Company shares the purpose of putting people to work. Together we can do more to get people back to work and help businesses be more productive by handling all of their employment, sourcing, recruiting, screening, and workforce management needs.

PeopleScout and HRX specialize in recruitment process outsourcing, RPO, which involves large-scale recruitment of full-time employees for clients such as Delta Air Lines, McKesson, and Bank of America. These service lines of ours fully outsource or complement the client in-house recruiting departments.

This is one of the fast-growing segments in the HR outsourcing space, and both of these service lines are leaders in their given geographic markets of the US and Australia.

Staff Management - SMX is an outsourced workforce management provider that recruits and manages contingent employees on-site at clients' facilities, and they serve customers such as Amazon, Mars, and Procter & Gamble. This service line uses centralized functions and processes combined with on-premise delivery to serve large-scale, high-volume facilities.

Given that the sourcing and application processes are automated and online, the costs associated with these processes are lower than a standard bricks and mortar delivery model, thereby allowing Staff Management to be very competitive while still producing 5% percent EBITDA margins.

Staff Management is also a leading provider of managed services, MSP. This management service collects a fee based on the total expenditure of contingent labor procured by their clients from staffing companies. This is a large and growing market, which we believe is less than 20% penetrated.

The new service lines we acquired all operate centralized models, with certain processes delivered directly at the client's location. They do not operate local market branches.

Patrick Beharelle joined TrueBlue and became President and Chief Operating Officer of TrueBlue Outsourcing Solutions, a new group that will include these newly-acquired service lines mentioned here. Each acquired service line continues to report to Patrick and is being led by its current leadership team. The group remains based in Chicago.

TrueBlue's existing service lines, which offer specialized staffing services include on-demand general labor, skilled labor, truck drivers, and our other focused service teams, comprise TrueBlue Staffing Solutions. This group continues to serve a broad customer base in the construction, manufacturing, transportation, waste, hospitality, retail, and renewable energy industries through a combination of our local market branches and certain centralized processes. President and Chief Operating Officer of TrueBlue Staffing Solutions, Wayne Larkin, continues to lead this group.

The use of recruitment process and workforce management outsourcing is growing quickly in the marketplace. Adding PeopleScout and Staff Management to our service lines dramatically expands TrueBlue's ability to provide these services to customers, and also adds to the Company's long-term growth potential in these high-demand services.

The international presence of PeopleScout, HRX, and Staff Management also opens up new international markets to TrueBlue, especially in Australia were HRX is located, and certain other European and Asian markets where PeopleScout has just gotten started in the RPO business.

The TrueBlue Staffing Solutions and Outsourcing Solutions groups are very complementary with each other. The Staffing Solutions group primarily uses a combination of local branches and some centralized processes, while the Outsourcing Solutions group will primarily use centralized processes with certain services delivered on-site at the client's location.

We immediately began testing the centralized services from these acquired service lines in our Staffing Solutions group to assist in our objective to reduce our dependency on our local branches, something we have been working towards in the past couple years.

Our new Outsourcing group has proven processes that are able to source and onboard applicants with a very low cost model. During the first half of 2014, we have consolidated about 40 branches, and anticipate an additional 20 in Q3. We do not yet have an estimate of how many branches will ultimately be closed, as we continue to carefully analyze the closing day by day and ensure we are not losing any opportunities to serve customers while operating fewer branches.

This has mainly happened in the large markets where we operate several branches. We are not pulling out of any markets with this approach. We are just executing our model differently based on the use of technology now available to us.

A good indicator that we are making progress that we expect is that our average annual revenue per branch has grown by over 40% in the last 5 years. We expect further productivity gains as we continue investing in processes and technology. I strongly believe by sticking to our strategy of being specialized for our customers, along with our focus of driving our internal efficiencies, we will continue to provide outstanding returns for our shareholders.

As we have stated, we remain optimistic about staffing and recruiting sectors. There are strong economic drivers, along with continued regulation, that make our industry an attractive solution for businesses that are growing and need help with workforce solutions.

We remain encouraged by our opportunity to grow our revenue and further expand our EBITDA margins as these strategies are executed. With strong revenue growth and expanding EBITDA margins, our opportunities to provide further shareholder returns is powerful.

We will now open up the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Paul Ginocchio, Deutsche Bank.

Paul Ginocchio - *Deutsche Bank - Analyst*

Hi, just a quick two questions I guess, one about SeatonCorp. I'm sorry, I just jumped on the call. Is there any trend or is the seasonality between the third and fourth quarter any different than you expected back when you talked about the deal?

It looks like there are a few more nonrecurring costs in the third quarter than originally expected. I think I had $1 million in my model; I think you are talking about $3.5 million. Is that correct? Thanks.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Hi, Paul, good morning. The seasonality with Seaton is maybe a little bit more than we originally had in the fourth quarter. If we break down what we talked about when we announced the transaction, we broke down a forward 12-month look into a back half of 2014 look and a first half of 2015. For the most part, the revenue there has largely stayed the same.

We have, in that forward-looking guidance, moved $2 million of EBITDA to the first half of 2015. That's not because anything has changed in our overall expectations. When we originally did our estimates, we made the EBITDA distribution between the third quarter, the first quarter, and the second quarter the same. And as we have gotten to know the business better, there are some costs that go into the third quarter to prepare the business for the big push that comes in the fourth quarter. That is the main change.

When it comes to one-time costs, there are more in the third quarter and that has to do with timing. Originally, we had expected, in the second quarter, $4 million of one-time costs related to the integration and acquisition of Seaton. We came in $2 million less than that, so in the third quarter in our expectations it's $3.5 million.

There's some more detail in the decks. To wrap up the one-time costs: our total expectation of $7 million hasn't changed. It's just the timing.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Thank you for that, Derrek. Paul, I appreciate your questions. Just to reiterate what Derrek said--there is no change overall to our estimates, just a slight timing difference between quarters on both the revenue estimates, EBITDA estimates, and this recurring cost estimate. So yes, we remain where we were a month ago. It's just in different quarters.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great. Then, Steve, we're seeing a nice acceleration in the ASA Staffing Index. And this morning, obviously, initial claims breaking out to the downside which is quite positive. We're just not seeing it in your kind of implied third quarter 4% organic growth, we're just not quite seeing the acceleration that maybe the ASA Index is showing, or maybe that we had kind of optimistically hoped for.

Is there anything -- do you see that in the marketplace, or is the ASA Index maybe overstating the acceleration?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

You have to remember that index is a broad index of different types of jobs; As I mentioned, Q2 was hit pretty hard and we do know that our Staffing Solutions, especially the project business, is somewhat the tip of the spear on both a rising economy and a falling economy.

Q1 hit us a little harder than we had realized, and when we saw the re-estimates of what GDP did in Q1, it all made sense. Maybe the weather drove that GDP and it's all the same thing, but Q1 hit us a little harder than we realized. That's one of the reasons you hear us applauding and being excited about 3% and 4%--it grew from 2% to 3% to 3%. And now here in July in the third quarter, we are seeing 4%. I know that that's not robust, but it's stable. And we are in the right sectors and recruiting the right types of jobs; we remain very optimistic about on-shoring of manufacturing logistics, and we are in those spots; and, as we mentioned, the power of bringing these two groups together.

So, no, we are not disappointed. I hear the callout of the different types of jobs that might be growing now, but we have the momentum we need right now.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great. Steve, you're not seeing any slippage in revenue from the branch closures, are you?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

No, we are on target for that. We are going to take it day by day and ensure that there is a benefit there and that the teams are coming together, and that we have the opportunity to serve the customers. Actually, on the customer side, it's going very well. The ability to contact and be with the customer and the way that we are running our sales teams is not the concern.

What we are really taking day by day is, with unemployment dropping quickly, we need to find the right worker count every day, day in and day out, for our customers. As we are using more of the centralized and online recruiting services, we have to analyze that day in and day out. Can we find the worker count we need to without as many branches? That is what we are careful of right now.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thanks very much.

Operator

Sara Gubins, Bank of America.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Thanks, good morning. Could you give us some more color on the seasonality of Seaton in the first and second quarters, just how revenue breaks down and if there is much of a variation in margins?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Sure. Almost 45%... let's call it 45% to 50% of the revenue is coming in. Let me make sure I get this right, here. Seaton on a pro forma basis will do about $700 million of revenue this year. Remember, that's pro forma, not actual. About $250 million of that comes in the fourth quarter, and the rest of that revenue is spread quite evenly across the quarters.

When it comes to gross margin, remember the overall gross margin directionally that we are expecting out of this business is about 16%. What you will see, seasonality-wise, from the first quarter to the third quarter is it growing 100 to 150 basis points. That is mostly as folks in the OWM business hit payroll tax thresholds and that cost comes down.

Then, in the fourth quarter, the gross margin can drop somewhere around 100 basis points in that quarter. That is not due to any change within the different service lines, but more of a mix issue because the OWM business is so seasonally focused in the fourth quarter, which carries a lower gross margin than the rest of the business, bringing the blended average down in that quarter.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay, great. So if we think about the $330 million to $340 million that you are forecasting for revenue in the first half of next year, splitting that evenly isn't an unreasonable way to do it.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

No, not at all.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. The 4% organic growth target for the third quarter, is that now back to normal or are there any project drags in there? And if you could give us an update on construction and energy projects.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

There's not any big overhang out there. Just to give everybody a recap of where our organic trends have been, remember we got hit pretty hard in February with the weather trends. If we took a look backwards on revenue... let me see if I have that handy and I will give it to you by month.

Organic revenue in April was 2%; May and June came in at 3%. As we ended June, that was the back half of June, it was closer to 4%. That's where we've started off in July, and I expect that trend to continue.

From a construction perspective, I think April was about 10% negative overall year-over-year in our construction business, and we finished June flat. So that was a nice trend to see. We hoped that that would, and did see some initial signs. I can't really comment on where things are headed in July. It's too soon to comment on that, but we are pleased to see the turnaround in those construction trends.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Great. Then just last question about the branch location closings. It sounds like it's going quite smoothly, given that you are able to do another 20 in the third quarter. I know that you were planning on watching it this summer and making sure that it was all smooth.

Were there any things that surprised you in terms of either client or potential worker behavior that's causing you to make tweaks to the way that you are thinking about this?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

No, we haven't had any big surprises come out of this. The third quarter, primarily in the Labor Ready business, is at seasonal peak, so we are moving forward cautiously with that timing. Those 20 branches are very doable; we are watching it closely and pacing it. If we can get 20 done, that's kind of our target here for Q3, we will certainly do that, but we also want to watch this really carefully through the busy season. Bottom line, there haven't been any big surprises and it is going right on track with trend and the plan of what we hoped we would leverage out of these, and no disruptions to the business.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Good, thank you.

Operator

Kevin McVeigh, Macquarie.

Kevin McVeigh - *Macquarie - Analyst*

Great, thank you. I wonder if you could just give us an update, Derrek or Steve, on how the current pricing environment has been, and if you are able to widen out the spread in terms of bill-to-pay rate.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I'll preface as saying it has always been competitive and still is. I will say that our teams are doing an outstanding job here, and I think that is reflected in our gross margin. I didn't comment on it in my script; the overall gross margin here for the business is almost the same as it was a year ago. I think it was just 10 basis points lower, despite the fact that we have about 40 basis points of headwind from the TWC acquisition.

That is strong evidence that our team is executing very well on bill pay rate spread, and adjusting the bill rates as needed, just doing great blocking and tackling month in and month out. I think we are doing a good job really across the board in managing both of those dynamics.

Kevin McVeigh - *Macquarie - Analyst*

Got it. Then, Derrek, along those same lines how should we think about -- obviously, you are doing a real nice job on the step-up and productivity vis-a-vis technology. But how are we thinking about that relative to overall margins and kind of the runoff, if you will, in the Workers' Comp, what kind of improvement on that? Should that be net neutral over the course of the cycle, or do you think the productivity enhancements offset any kind of headwind, if you would, from Workers' Comp; or am I not thinking about that right?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I think we should probably put those in different categories. I don't think there's really anything to talk about right now on Workers' Comp; we have a pretty stable trends there. When it comes to the productivity, we are really looking at what we are doing on an SG&A percentage and what we are doing with billable hours and revenue and gross profit per employee, and those are all really headed in the right direction. While we have not prepared to talk about all of that today as far as numbers go, where we are headed with technology, and the size of the branch footprint that we have, we have so many opportunities in reducing this. And the Seaton transaction, as Steve has mentioned, is going to be a big help for us on that.

We have a lot of planning going on right now. It's too early to talk about all that, but I'm confident that both of those things are going to really help us (technical difficulty) leverage that we've got in our legacy business.

Kevin McVeigh - *Macquarie - Analyst*

Thanks so much.

Operator

Jeff Silber, BMO Capital Markets.

Jeff Silber - *BMO Capital Markets - Analyst*

Thanks so much. We have been reading a lot about supply constraints in a number of different areas, and I know it's creeping in potentially to some of the areas that you focus on. I was wondering if you can address that if you are seeing that, and what measures you are taking to offset that.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Yes. With unemployment coming down, we do feel the impact. As we all know, part of that employment coming down is people dropping out of the workforce, and the long-term unemployed is becoming a larger number. And those folks that have totally dropped out, it's quite a shame, actually.

That's part of the number dropping, but there's a slight constraint there. It is getting harder to find certain jobs, especially those with skills, but that's why clients bring us to the table, is the hunt for those folks. In certain specialty jobs, our unfilled order rate has ticked up slightly, which would mean there is a little bit more demand than supply. It's not totally out of balance. We are paying attention to it.

Increasing our online presence and our ability to source a workforce through an online ability is increasing and that's helping, and we are not pulling back on our branch structure to the degree where we can't fill all of our general labor jobs right now. So, in the general labor category, we are doing fine. In certain skilled jobs, the hunt is getting slightly tougher.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. As a follow-up actually, Derrek, I just had some questions about the guidance. Your third-quarter EPS guidance of $0.38 to $0.46, does that include the impact of the nonrecurring acquisition costs? And if not, what would the impact be of those costs on EPS?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, Jeff, our third-quarter EPS guidance does include those costs, which we expect to be about $3.5 million.

Jeff Silber - *BMO Capital Markets - Analyst*

And how about the after-tax impact of that?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Just take it at 60%.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Excuse me 40% tax rate.

Jeff Silber - *BMO Capital Markets - Analyst*

Sorry about that. In terms of interest expense for the quarter?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

The interest rate on our debt is running about 2%. We started out the quarter with about $190 million outstanding on that. We will finish at $170 million, so that gives you kind of a breakout. Run 2% on $180 million of debt, and drop that into as an addition to your model.

Jeff Silber - *BMO Capital Markets - Analyst*

The $20 million in lower debt at the end of the quarter, is that the run rate going forward?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I would guide you this way: We will drop down to$170 million of debt at the third quarter because of the seasonality. Particularly with the Outsourcing Solutions group and their OWM business, that'll climb up to about $200 million at December.

And then if we want to take alook toward January, I believe I have the number here for you...that's going to drop down considerably, maybe down to $150 million in debt. But let me take a look real quick before I give that to you. Actually, let me come back to that one, Jeff, if you don't mind.

Jeff Silber - *BMO Capital Markets - Analyst*

Not at all. Actually, that will be very helpful. I think that is it for me. Thanks so much.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I got it. Why wait when you have, right?

That $200 million of debt will drop down close to say $150 million--$160 million in January, and then we will start a slight seasonal build. You can just kind of take a look at where our accounts receivable is, but the main thing here is the jump from Q3 to Q4 that will happen each year with that seasonality.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. That's very helpful. I really appreciate that color. Thanks.

Operator

(Operator Instructions) Randy Reece, Avondale Partners.

Randy Reece - *Avondale Partners - Analyst*

Good morning. I was wondering if we could discuss the seasonality of the RPO business in particular. Does that business look more linear, or is there a particular quarter or two where they have more activity?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I want to stay a little bit more at the Outsourcing Solutions group level. I think the best way to think about this, Randy, is that the other offerings that are provided there are going to be fairly linear types of margin profiles.

The one thing that is a bit different in the areas that are not staffing is that these are larger customers and there can be a little bit of lumpiness, but not that much. When you bring on a large customer, let's say an RPO, the economics here are not as cookie-cutter as staffing.

In other words, you've got to prepare right for that large customer, bring on; you've got startup expense. You've got to gear up ahead of that revenue stream, whereas in a traditional staffing environment, the economics are pretty cookie-cutter. Everything kind of falls in line with that revenue.

With that said, I don't think that's too much for you to worry about as you take a look at future expectations. And if there is that type of lumpiness, we will certainly explain it, but I don't think it's anything to be concerned about.

Randy Reece - *Avondale Partners - Analyst*

It's early on after this acquisition, but what are your thoughts about balancing the desire to invest in the growth opportunities of SeatonCorp versus to maximize current earnings from that business?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

It's a great question. We've got to let the dust settle here on the integration, but as mentioned here today already several times, we are excited about these platforms. They are the high-growth items out there in the HRO space. We are mainly North America, so we feel like we have got a big field out there to go play in, in both RPO and MSP.

This is exciting stuff for us. We are going to stay mainly focused in North America for right now, because what we have found is that there is an amount of requests for proposal in the Staffing Services, that because we couldn't serve the larger accounts at the lower margins that the bidding process was going for, we now have a partner and we can flip those RFPs over to the Outsourcing group.

And the same thing is going on over at the Outsourcing group. They come across client requests and requests for proposal where they just can't quite fill the demand at the local market level at the speed that's necessary or the order size or the type of position. And now we have a place to flip those.

The main thing for us is, one, get it integrated, get the efficiencies out of those things that we can do. And two, then jump right in to grabbing these cross-sell opportunities here in the US. We will grab that quickly.

I think we are going to be better prepared to answer that question in six months of, "Now what?" We've got to make sure we really understand the seasonality of the business and what it does to cash flow demands and the debt levels. By spring, we are going to know that we got it right.

Just as we mentioned here today that one month ago, we didn't quite guide properly between Q3 and Q4, and now we've got that under play. We have a lot to learn here.

Randy Reece - *Avondale Partners - Analyst*

Looking at the business mix on the staffing side for Seaton, how much of that business is essentially managing the customers' employees as opposed to more like temporary staffing? And is there a difference in the growth rate between the two?

The more of the outsourcing business you do, you are not going to get the same gross margin managing the customers' employees, but I would think that your cost structure would be different, too.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Yes, that is the goal there. And as we have mentioned, getting similar EBITDA margins out of these is going to be important for us. When things are booming and the construction business is booming and we are getting higher gross margins out of our staffing services solutions, they are going to drive higher EBITDA margins.

But in an overall cycle and the averages of all this and really where construction has been the last five years, we can drive similar EBITDA margins out of these businesses. And we can surely grow them from where they are on a consolidated basis.

Randy Reece - *Avondale Partners - Analyst*

Thanks.

Operator

Mark Marcon, R.W. Baird.

Mark Marcon - *Robert W. Baird - Analyst*

Good morning. Thanks for taking my question. First of all, I just wanted to ask about the base business, the legacy business. Can you give us a feel for where Boeing turned out?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, I can talk about that, Mark. The Boeing business, the run rate, what we turned in this quarter has been the same run rate of revenue that we have had for the last three quarters. You will find us talking about that much less going forward, just from the standpoint that now that's come down to a pretty stable level; now it's less than 1% of our pro forma revenue running forward. It's stable; it's just a small amount at this time.

Mark Marcon - *Robert W. Baird - Analyst*

I appreciate that. I was just trying to take a look at your organic revenue growth ex-Boeing, since that's still a drag.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, not too much impact there, Mark, from Boeing.

Mark Marcon - *Robert W. Baird - Analyst*

All right. Then can you break down what you're seeing with regards to the various brands that you have in terms of the legacy business, in terms of what's growing and what isn't in terms of that 3% to 4% organic growth?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

What I can do here is just kind of talk directionally what's going on, and I will talk about this a bit starting at kind of a quarterly level. If we were to compare back to what was going on in Q1, I think the main change here, particularly as we looked through this quarter, was the reversal of the construction trends. It's running down about 10%, and that coming around to flat as we finished the quarter.

Most everything else in the business has been pretty consistent, both from an industry perspective as we look across the board and also geographically, not any big standouts. I think this theme that we have been talking about over the last year or two about this being widespread across sizes of customers, across geographies, really still applies to this quarter.

Mark Marcon - *Robert W. Baird - Analyst*

Okay. So no real regional differences, no real differences between the various elements of the brands in terms of the trends.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Not really, Mark.

Mark Marcon - *Robert W. Baird - Analyst*

Then with regards to the closing of the 20 branches, where would you expect those savings to come in?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Are you talking about time periods or where we would see the value in the P&L?

Mark Marcon - *Robert W. Baird - Analyst*

No, how much would you expect? You've given metrics before in terms of how we should think about those.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, thank you for clarifying there. The general EBITDA impact per branch would be roughly about $100,000 annually, and about half of that is from headcount, from a position, and the other half related to reducing fixed costs. This is net, by the way, of some estimate of revenue loss and the associated gross profit.

So let's call it about $100,000 of EBITDA benefit that will pace in, not all at the time we close it. Half of that will come relatively quickly because of the fixed cost nature of it. The variable piece with the headcount, we will phase that in. If there's a position open somewhere in that market, it comes quite easily. If it's not, we go through a process of making sure we retain the best folks. And often times other positions open up and we move folks into those positions. That's how I would think about it. So that other half may take a couple quarters to phase in. And I would also say as we go in here to the third quarter and we're doing our closings, we are going to be very careful about that because we want to watch this headcount really closely and make sure that we are not reducing that too fast in the third quarter. This is mostly Labor Ready, hits its peaks here, but we are managing that very closely as we look forward to the rest of the year for sure.

Mark Marcon - *Robert W. Baird - Analyst*

Great. Then can you talk a little bit about the texting initiative and the mobility initiative, just in terms of how that's going? And what sort of impact are you seeing with regards to the fill rates that you alluded to earlier?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

It has been a real efficiency gain and really turned out to be a huge benefit for the workforce. The feedback and the comments there have been our largest gainer so far. While we have these branches still open, though, the dependency hasn't been totally cut off, and so we don't force it. We take the path of least resistance there.

One thing we do know is it can happen. As far as use of and the number of workers flowing through there, it continues to increase. The number of messages continues to increase every quarter. The use of the system increases, which just feeds our confidence level of really not needing that branch for morning dispatch purposes.

That gives us the ability to push the consolidation efforts a little bit stronger, especially as we're building a sales force outside those branch walls also that covers a given marketplace, and we know the customer is being taken care of without that branch location. It's kind of a larger package than a one-off thing. It comes into play with paying in the afternoon and building the sales force, along with our most current initiatives that are underway, that is, how does a worker really find us and apply in a branch? That is the number one initiative underway--without that branch in play, can they still find us? Can they find us online? Can they find us in other ways, in community events and job fairs, and what does that pipeline look like?

It's so larger than just the one item to isolate. What I can say is that we are happy with the effort. It allows us to take it further and really reduce the functions that are going on in the local market to a deeper level. It is the thing that provided the spark to move everything else forward.

Mark Marcon - *Robert W. Baird - Analyst*

So given that you are proceeding with that, in the regions were you have done more of these closures, obviously you're not pulling out of any specific market. But where you've done more of those, you haven't seen a material change in the fill rates that's different than the other markets where you haven't done as much?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Well, we have a few one-offs that were pretty bad examples. We won't talk about those because we have some one-offs that were home runs. You look at the mainstream; you know how the 80% are going and they are going as expected. We just have got to watch it closely like we've stated here. It is a day in and day out thing in the middle of this busy season, and as unemployment trends change and it is pocket-based. The main thing is to fill all the job orders; that is more important than consolidating a branch.

Mark Marcon - *Robert W. Baird - Analyst*

Then can you discuss the bill rate changes that you ended up seeing during this past quarter, in terms of where bill and pay rate changes ended up coming in?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes. You know, we have been a little hesitant to share that because of mix changes, but let me see if I can give you some guidance here, Mark. If we're taking a look at where bill and pay rates are going, I would say -- I'm just kind of scanning things through here because I don't have a mix adjusted calculation here in front of me.

I would say we are running approximately, here in the second quarter particularly, around 2% on bill rate inflation and pay rates are averaging something less than that, maybe in the 1% range.

We saw some nice pickup here, and actually we've been doing quite well on this whole area over the last couple of years with our pricing. We don't see any changes to that. We are doing a good job here and feel really good about where we are headed.

Mark Marcon - *Robert W. Baird - Analyst*

Okay. Do you think that as we take a look at like the California minimum wage changes as we look ahead, that bill rate change continues to edge up?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, I think you will. I think we can get some more color on that in the third quarter. Let me give you a little bit of fill-in there on California. That is our biggest minimum wage increase for the whole year of any particular state. Of the minimum wages increases that we have for the year this year, that's about half of it.

I will tell you we are thrilled at where we have started this process. We take a look back where we ran in July. I will throw out the first week of July because you've got the holiday week in there. Weird things can come into trends on those holiday weeks.

But if you take a look at the two weeks following that, we executed extremely well. Not only have we passed everything through, gross margin has stayed the same as what it -- exactly where we expected. We had no slippage right out of the gates.

The thing that we need to be -- I will just caution everybody here -- while we are thrilled with it and we couldn't have started any better, the thing that we haven't seen is what happens in the next month or the next month is; is there any attrition from clients or competitively folks that didn't do those types of pass-throughs, where that trend could erode.

But we are thrilled about it and think that that is just another kind of testament to our confidence to be able to continue to pass through these regulatory costs, particularly in the Staffing Solutions group with our history there.

Mark Marcon - *Robert W. Baird - Analyst*

Great. I'm sorry I missed it; I know you've mentioned it, but I didn't copy it down as quickly. What was the assumption with regards to the tax rate for the third quarter?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

40% effective income tax rate.

Mark Marcon - *Robert W. Baird - Analyst*

So no assumptions with regards to WOTC.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes, I am glad you brought this up. I know this can sometimes be confusing for those that may not follow this day in and day out with the staffing industry. When we are talking about WOTC, and I think what you are referring to here, Mark, is the renewal of WOTC for the 2014 year, which has not yet happened.

From a GAAP perspective, we can't recognize any of that until the approval goes through in Congress. And by the way, I don't have really any updates on that. At that time, we will recognize it from an accounting perspective, and we don't pull into our guidance any speculation around those types of things.

Mark Marcon - *Robert W. Baird - Analyst*

And some of the exceptional performance that you had during this last quarter with regard to recognizing some things that occurred previously, is there any anticipation that any of that could come through at all, or you pretty much captured everything?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I would describe it this way, Mark--we don't have anything that we are anticipating in the tax line that we have high confidence enough that we can put that into the forecast. What I will say when it comes to WOTC and our overall tax planning strategies is that we are always working that very, very hard.

And I don't have anything to report here, but there could be in Q3, could be in Q4. But I don't have anything that I'm speculating or have ready to talk about there.

Mark Marcon - *Robert W. Baird - Analyst*

Can you just describe the early interactions, both with regards to the Seaton folks in terms of what sort of levels of turnover you are seeing over there relative to what they were experiencing prior to the announcement, the level of enthusiasm; and some of the early interactions that you may have had with some of their clients?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Thank you for that. It has been powerful. We've been together three full weeks, heading into our fourth. That first week we got senior teams together, and I've got to tell you there was more enthusiasm and more ideas about how to share these requests for proposals that both couldn't fill. That recognition was strong.

We immediately put process in play to capture that work, and I'm excited that that's really going to drive some better results as the process takes hold and we actually address those gaps. So that's good news.

Turnover of senior team members has not even happened. We retained everybody that we intended to. I know we are only a month into it. Key leaders down two, three levels, there's just been no change. They are quite excited over there. They were owned by a great private equity firm, and they knew they were for sale and that they were going to go through the process, where they might land, and they are thrilled that they landed with an organization that is just building a new platform in outsourcing rather than landing in one where the senior team might have been marginalized and been called a synergy. They are excited that that is not what they are being called right now.

And they are part of our growth strategy and the importance of running that business and retaining them. They have been engaged not only in integration but how to run the businesses better, so we are real excited about that.

Interaction with customers has been strong. In our legacy businesses we serve 140,000+ customers, besides a handful of intimate customers that we've discussed on this call once and awhile.. Most of the customers are small regional. Even if they are a large player, they are served on a smaller regional basis; the customer intimacy side on our legacy businesses isn't that high.

They serve 150 accounts, and the customer intimacy over there is real strong. Getting to know those customers and understanding what their needs are and what their concerns are is a lot more important on that side of the house. It's larger accounts. I have been spending time back there in Chicago every week talking to their customers, talking to their leaders, attending their client forums.

I've been involved with some of their largest accounts and the enthusiasm and the acceptance of being part of a large publicly-traded company that is governed well and the investment is stable, most of those accounts are pretty thrilled that their management team has a fairly stable home and that the asset won't be trading regularly amongst private equity.

So again, the private equity owners, Leeds, managed this one very well and grew it nicely, and the team enjoyed working with them. But they are also excited to be part of one of America's most trustworthy companies now, as identified by Forbes. So it's all good.

Mark Marcon - *Robert W. Baird - Analyst*

It's great to hear. Thank you.

Operator

Josh Vogel, Sidoti.

Josh Vogel - *Sidoti & Company - Analyst*

Good morning, thank you. I'm sorry, I missed the comments you had about the branch consolidation in your prepared remarks. I was curious what you -- how many branches you ended Q2 with.

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Good morning, Josh. We ended the second quarter of 2014 with 722 branches. Included in that count, as we count them, are three additional branches. I will just point out, though, that those three aren't your traditional branches. These are more temporary on-site locations without bricks and mortar. They are included in the count, but that's not new fixed cost structure there.

Josh Vogel - *Sidoti & Company - Analyst*

Okay. And you said on the last call you had plans for about 40 more closures throughout 2014. So you had 15 in the quarter. Are you still on pace for that 25 in the back half of the year?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

Yes. Directionally, we are on pace for that. We are very comfortable with that number. It is a matter of timing and making sure that we don't disrupt any operations. The only thing that we've talked about here, and I'm not hedging against this at all, we are very comfortable with the number.

I just want everyone to know that as we go into the third quarter, it is our busy season. So what we don't want to do here is not serve the customer well, disrupt operations. Put this another way, we don't want to step over dollars here of long-term value and pick up dimes in the quarter. We are going to just continue to manage that way, but we are very much on track for that 60 branches.

Josh Vogel - *Sidoti & Company - Analyst*

Okay, you also on the last call talked about -- and then you even mentioned it this call that your average revenue per branch is up 40% over the last five years. And you did give us some numbers of, I think it was like $1.65 million in 2008, $2.3 million per branch in 2013. So now that we are halfway through 2014, do you have a sense where average revenue per branch is today?

Derrek Gafford - *TrueBlue, Inc. - EVP & CFO*

I think I have that. Let me take a look for you. Average branch revenue right now is running about $2.2 million per branch. That does exclude any skew that could happen by including the PlaneTechs operation.

Josh Vogel - *Sidoti & Company - Analyst*

Okay, great. Just lastly, building off one of the earlier questions about the email and texting platform, this may be hard to answer but is that -- are those placements or is that at a scale yet where you could give us a sense of what percent of your placements come from that platform, and where that stands versus a year ago?

Steve Cooper - *TrueBlue, Inc. - President & CEO*

No, we can't give you the number, nor do we feel that it's meaningful for you. Maybe a better number as we develop out our online recruiting, is how many people are we contacting or recruiting online, that might be a more meaningful number. Because keep in mind all of these workers we're texting, we've already dealt with and onboarded at the branch level, and it's just how we get them assigned out to the job each day. They don't need to come into the office to pick up their work ticket.

Really the benefit of giving you that number, how many went through text assignment versus came in and got the paper, doesn't drive results. From a management point of view, it helps us understand if can we really consolidate another branch? Do we have enough people being text and getting their assignments, or is that branch necessary for morning dispatch, but it's not driving anything else?

A more meaningful item will be without a branch in play, can we still find the workforce? How many are signing up online and other ways that we are finding that workforce? As this gets a little deeper into the year or into early next year, we will possibly be talking to you more about that because that's the next giant step forward in really reducing that dependency.

Josh Vogel - *Sidoti & Company - Analyst*

Sounds good, thank you.

Operator

Now I would like to turn the call back over to Steve Cooper for closing remarks.

Steve Cooper - *TrueBlue, Inc. - President & CEO*

Thank you. We appreciate you being with us today and sticking with us in understanding how our trends are performing, and especially this newest acquisition. As we are learning and disclosing and guiding you through that process, we really appreciate you hanging in there with us.

We are excited about our momentum, and that although in a large acquisition, the first quarter or two it takes a bit to get it straight, hang in there with us. The momentum is there, the revenue is growing, and the EBITDA margins have all the ability in the world to keep expanding. Thank you, and have a great day out there.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a good day.
