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TBI - Q1 2015 TrueBlue Inc Earnings Call

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CORPORATE PARTICIPANTS

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

Steve Cooper *TrueBlue, Inc. - CEO*

Derrek Gafford *TrueBlue, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Ato Garrett *Deutsche Bank - Analyst*

Randy Reece *Avondale Partners - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2015 TrueBlue earnings conference call. My name is Denise, and I'll be the operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question-and-answer session. (Operator Instructions)

As a reminder, this conference is being recorded for replay purposes.

I will now turn the conference over to Stacey Burke, Vice President of Corporate Communications. Please proceed.

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

Thank you, and welcome. We appreciate everyone joining us on 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 Exchange Commission.

The discussion today also contains certain non-GAAP financial measures. Information relating to the comparable GAAP financial measures may be found in the press release and presentation slides, which were 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. - CEO*

Thank you. Good afternoon, everyone. Today we reported our first quarter of 2015 revenue grew 45% to $573 million, which produced $19 million of adjusted EBITDA, an increase of 156% compared to a year earlier.

Both revenue and earnings exceeded expectations this quarter. We are encouraged by the momentum we felt at the end of the quarter and here into the beginning of the second quarter. The first quarter had severe weather impacts, along with negative impacts of the ports being closed for some period of time.

Even with those setbacks, we are pleased with the success of our growth strategies, which produced record first-quarter revenue and net income.

The recruitment process outsourcing RPO business and the outsourced workforce management OWM business that we acquired on the first day of the third quarter of 2014, are continuing to win in the marketplace and are delivering impressive results.

In addition, strategies we have implemented over the past year in our staffing businesses have produced 50% growth in adjusted EBITDA from these operations.

TrueBlue is well positioned for continued growth in our staffing businesses, given our capabilities to serve small local companies in over 400 industry classifications and to serve large national companies in focused industries such as construction, logistics, manufacturing and hospitality, along with many more.

We see ourselves positioned in the right growing industries with the right service capabilities to continue our momentum in this expanding economic environment.

Businesses are searching for and finding the right mix of contingent and permanent workers to drive their businesses forward. In this regard, we can now offer more to our customers than ever before and serve new customers because of the investments we've made this past year.

It remains a great environment to be a leader in delivering world-class talent solutions that improve the performance of our customers.

The acquisition of the OWM and the RPO business in 2014, included the industry-leading brands of Staff Management, PeopleScout, and hrX.

We're excited about the future growth opportunities we have in the RPO business. The RPO business is a fast-growing segment in the global human capital space. PeopleScout and hrX are positioned well in this space, with award-winning service delivery.

We are seeing an increasing number of deals on a global basis come to market for permanent hire recruiting.

With our leading service provider, PeopleScout, here in North America, along with small pockets around the globe, and with hrX in Australia, we are positioning TrueBlue to be able to respond to these global RPO opportunities.

We are building strategies to become the global leader in RPO by ensuring our RPO delivery model can deliver the same award-winning service we've been recognized for here in North America, in both Europe and Asia.

Our Staff Management workforce management service line is serving some of the largest and fastest-growing companies in North America. We are proud of the quality service they are delivering and are excited about how they will shape TrueBlue as we continue to grow and develop our service capabilities in contingent labor on a global basis.

Given we operate staff management as a centralized business with on-premise delivery, we believe we can expand this service line globally more efficiently than a branch-based business, especially as we see requests coming in from current customers for us to serve them globally.

For our staffing businesses, we have continued to make progress in building a more efficient business model here in North America, through the use of technology and combining certain leadership, sales, recruiting, and service teams across our legacy business lines.

This has allowed us to close approximately 150 branches over the past two years, while sustaining the revenue base in those combined markets by maintaining strong operations and customer support.

Cost savings related to those closings continue to show up in the operating leverage here in early 2015, and we continue to produce substantially all the revenue with a lower base of costs. We do expect to see expanding profit margins through 2015, as a result of these closings and consolidations.

We don't expect a significant number of additional closings or consolidations in 2015, as we anticipate a tightening labor market. And we need to ensure we have adequate resources in the markets to deliver and fill the rising demand.

Given some time to mature, the newer consolidated services and better understand the resource needs market by market, we anticipate we could consolidate additional branches. We are just not undertaking that initiative here in 2015.

We remain enthused with the growth opportunities in our business. We are in the right service lines that are showing growth and demand. With our focus on a broader spectrum of capabilities for our customers, we have the opportunity to improve our growth rates from here and continue to deliver the right workforce at the right time to the marketplace. From general labor to skilled trades to workforce management and recruiting full-time positions, we find ourselves well positioned in sectors that are growing.

We are also encouraged that our adjusted EBITDA margins expanded in 2014, by 20 basis points, and in Q1 of 2015, by an additional 150 basis points.

Our goal remains to surpass 6% adjusted EBITDA margins and continue to grow it beyond that, which we believe is within reach.

Let me turn the call over to Derrek for further analysis and commentary, after which, we will open it up for questions. Derrek.

Derrek Gafford - *TrueBlue, Inc. - CFO*

Thanks, Steve. As a reminder, we purchased Seaton Corp., effective the first day of the third quarter of 2014.

In addition to our consolidated reporting, we have also provided standalone reporting for the legacy TrueBlue and Seaton businesses. We believe this approach provides the most transparency to help investors assess our performance.

Once we have a full year of ownership to provide prior-period comparisons, we will provide reporting for two new business segments. The first, managed services, will include the recruitment process outsourcing and managed service provider businesses. The second, staffing services, will include all of our staffing operations. Until we reach the anniversary of the Seaton acquisition, we will continue to discuss the business from a legacy perspective.

In my commentary, I will reference two non-GAAP terms - adjusted earnings per share and adjusted EBITDA. Adjusted earnings per share excludes non-recurring acquisition and integration costs, amortization of intangible assets, and adjusts income tax expense to a 40% marginal rate. Adjusted EBITDA excludes non-recurring integration and acquisition costs.

These are measurements used by management that, in our opinion, enhance prior period comparability and provide additional value to shareholders in assessing performance.

Adjusted earnings per share for the quarter of $0.20, was $0.07 above our midpoint expectation. Higher revenue in the acquired service lines, contributed to half of the outperformance, with the remainder from higher gross margin and lower operating expenses in the legacy TrueBlue business.

The strong across-the-board performance this quarter expanded adjusted EBITDA by 150 basis points.

Now let's take a closer look at this quarter's results, starting with revenue. Total revenue grew by 45%, driven primarily by the Seaton acquisition. The acquired on-premise staffing and RPO businesses are performing very well. They continue to deliver impressive results, and revenue pipelines are strong, particularly on the RPO side.

Revenue was largely flat in the legacy TrueBlue business. A drop in year-over-year green energy produced three points of revenue headwind. We expect another point or two of green energy headwind next quarter, until the existing revenue run rate anniversaries at the end of Q2 this year.

Gross margin was 22.6%, down 250 basis points. The Seaton acquisition, which carries a lower gross margin than the legacy TrueBlue business, dropped the blended average by 290 basis points. Within the legacy TrueBlue business, focused attention in pricing new and existing customer bill rates created 40 basis points of gross margin expansion.

Now let's shift to sales, general and administrative expense. SG&A was up $20 million, mostly from the acquired Seaton operations. Lower SG&A in the legacy TrueBlue business was largely offset by one-time integration costs. SG&A as a percentage of revenue was 19.5%, down 370 basis points, largely due to the blended impact of Seaton, which carries a lower SG&A percentage than the legacy TrueBlue business.

We recognized an income tax benefit equivalent to $0.03 a share, from a higher-than-expected yield of tax credits associated with prior year programs. Keep in mind that this benefit is already excluded from our adjusted EPS calculation.

Adjusted EBITDA margin improved by 150 basis points, with roughly 100 basis points coming from fundamental improvement in the legacy TrueBlue business. Another 50 basis points of improvement is from the Seaton business, which carries a higher margin in Q1 versus the Q1 seasonal low in the legacy TrueBlue business.

Net income was $5.7 million, or $0.14 per share on a GAAP basis. Adjusted EPS was $0.20, which includes $0.02 of add-back for non-recurring integration costs, $0.07 of add-back for intangible asset amortization, and $0.03 of deduction to adjust income taxes to a 40% marginal rate.

Turning to the balance sheet, we ended Q1 with about $110 million of total debt, $90 million less than Q4 2014. The majority of the debt reduction came from a $70 million drop in accounts receivable, as it deleveraged this quarter from its seasonal peak in Q4.

Total cash was roughly $20 million and credit line borrowing availability was about $150 million.

Looking ahead to Q2 2015, we expect total revenue of $627 million to $642 million, or growth of about 40%, which includes the following assumptions. Legacy TrueBlue revenue of $462 million to $472 million. This represents organic growth of 3%, or 4%, excluding green energy. Also included in this assumption is Seaton revenue of $165 million to $170 million.

Total company adjusted EBITDA which excludes Seaton integration costs, should be $32 million to $35 million, and includes the following assumptions. Legacy TrueBlue adjusted EBITDA, of $26.5 million to $28.5 million, and Seaton adjusted EBITDA of $5.5 million to $6.5 million.

Here are a couple of remaining consolidated assumptions. Gross margin should be 23.7% to 24.1%, and CapEx of about $5 million to $6 million.

We expect adjusted EPS of $0.37 to $0.42, which uses a marginal income tax rate of 40% and excludes $1 million of expected Seaton integration costs and $4.5 million of intangible asset amortization expense.

We like how we're positioned for growth. The Seaton acquisition squarely positions us in the high-growth RPO market, and added on-premise staffing expertise to our core business. We're excited about the growth opportunities for both of these new businesses, as well as the international prospects.

With healthy gross margin trends and a tight cost structure, the legacy TrueBlue business is prime for strong operating leverage.

Favorable outlooks for construction and small business growth play to the core strengths of the legacy business. These outlooks, combined with our strategies bode well for the delivery of 15% incremental EBITDA margins in our legacy business.

Strategic acquisitions are an important part of the growth strategy and the balance sheet is in great shape. With half of the debt from Seaton acquisition paid, debt is now under one turn of adjusted EBITDA.

Finally, I'd like to remind everyone that a variety of additional information on our performance can be found in our press release, earnings release deck, and road show presentation located on our website.

That's it for prepared comments. We can now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Sara Gubins with Bank of America Merrill Lynch.

Unidentified Participant

This is actually (inaudible) calling in for Sara. Can you just provide us -- can you quantify for us the impact that weather had in the quarter?

Derrek Gafford - *TrueBlue, Inc. - CFO*

Yes, the impact of weather. It was at least a point of revenue headwind. It's a little challenging to estimate the port shutdown impact. But I think it's safe to call it 1%-plus for the quarter.

Unidentified Participant

Got it. Okay. And can you also give us a little bit more color on what drove this strong performance in Seaton?

Steve Cooper - *TrueBlue, Inc. - CEO*

Could you repeat the back part of that question a little louder?

Unidentified Participant

Sure. Could you give us a little bit more color on what drove the strong performance in Seaton?

Steve Cooper - *TrueBlue, Inc. - CEO*

Yes. I think it's just general market conditions that larger companies are continuing to grow, and that's what's driving our outsourced business, which really is serving large contingent needs of some of the fastest-growing companies here in North America. And the battle for labor at all is getting pretty strong out there. And the fact that we have a delivery mechanism to deliver to these large onsite implementations is really powerful.

So we're winning in the marketplace on those large contingent orders on-premise.

On the permanent side, there's just a lot of demand. Companies are running out of avenues to find their own people and they're turning to outsourcers to help bring this sourcing to the market.

PeopleScout just happens to have the world-class delivery model, awarding winning service delivery here in North America and they're winning a lot of proposals.

So the combination of a labor market that's shrinking with two service models that are powerful and proven, I think is providing great results for us.

Unidentified Participant

I see. All right. That's all I had. Thank you.

Operator

(Operator Instructions) Ato Garrett with Deutsche Bank.

Ato Garrett - *Deutsche Bank - Analyst*

I had a question about the 60 basis points improvement in the operating costs at legacy TrueBlue. I wanted to see how much of that was from branch closures or if there was anything else that contributed to that.

Derrek Gafford - *TrueBlue, Inc. - CFO*

Yes, Ato, that's mostly what it is. This quarter, too, as I said, was a smaller revenue quarter for us. And the leverage can be moved quite substantially with some change in the costs. We're talking about a couple million dollars of cost reduction here year-over-year, and most of that was driven by the branch consolidations that we did last year.

Ato Garrett - *Deutsche Bank - Analyst*

Okay, great. And also, looking at Seaton, about how much was Seaton growing in the first quarter?

Derrek Gafford - *TrueBlue, Inc. - CFO*

Seaton's been growing at a healthy 15% clip, really, if we average it, since we bought the company. And it's been pretty equal growth across both businesses, both the RPO side and the on-premise staffing business.

Ato Garrett - *Deutsche Bank - Analyst*

Okay, great. And then finally, could you just give us an update on what you're seeing in construction end market? And then remind us what percentage -- what's your overall exposure on a consolidated basis to the end market?

Steve Cooper - *TrueBlue, Inc. - CEO*

Sure.

Derrek Gafford - *TrueBlue, Inc. - CFO*

Yes. With construction, as far as the momentum of the overall sales trends, those have been relatively consistent. I'll speak right now to our general labor brand, Labor Ready, where most of it is concentrated.

The revenue trends in that business have been flat-to-slightly-negative for the last couple quarters. Not much change here this quarter. And that's the way it appears on the surface. There are some underlying trends that we're excited about.

California for us makes up approximately 15% of our construction business. We have seen accelerating trends in the California area, predominantly middle and southern California. And those reached over 10% this quarter. That was a nice trend movement for us compared to last year, maybe [right at about] 5% growth.

Texas makes up about maybe 5% of our revenue in construction. That went the other way. It's been influenced by oil, certainly. And the other big one for us is Florida. Florida makes up about 15%. And if we were to look back to last year, that trend was in the negative, mid-single digit, underperforming, from our perspective. And we have seen a nice bounce there, particularly coming into the second quarter of growth at 5% and approaching 10%.

It's early into the second quarter, so that's only three weeks of information. But we're encouraged. And that's a big focus area for us, to get this construction trend turned in the direction that it should be and that we're capable of delivering.

Ato Garrett - *Deutsche Bank - Analyst*

All right, great. And then also, just as a percentage of overall revenues, what's your exposure to construction?

Derrek Gafford - *TrueBlue, Inc. - CFO*

On the legacy TrueBlue side, let's call it trailing $1.7 billion of revenue, this constitutes about 25%, so let's call it the lower $400 million.

Ato Garrett - *Deutsche Bank - Analyst*

Okay. Thank you.

Operator

Randy Reece with Avondale partners.

Randy Reece - *Avondale Partners - Analyst*

I was wondering if I could get into a little more on the Seaton side, the difference in performance between your managed services business and the outsourced workforce management business.

I understand in outsource workforce management, you had some customers you were expecting to ramp up in the beginning of this year. Did that happen as expected? And then how was the performance in PeopleScout?

Steve Cooper - *TrueBlue, Inc. - CEO*

Yes, thanks for that question, Randy. My understanding is we're going to compare and contrast a bit, PeopleScout and Staff Management, what's going on there. And we have different buzz words and different industry words. So I just wanted to clarify what we are talking about here.

Randy Reece - *Avondale Partners - Analyst*

Yes.

Steve Cooper - *TrueBlue, Inc. - CEO*

Yes, they're both ramping nicely. As Derrek talked, both are growing at similar rates. They've definitely got different metrics that drive them, though. The EBITDA margins in our RPO business are 20%-plus, where our EBITDA margins in the outsource workforce management, the Staff Management, are pretty close to the company averages, just slightly less.

We like to see that growth in that RPO, and that's one of the reasons we're all excited -- seeing the performance of that and where it's going and the world -- actually, the global opportunities, to see the growth capacity that's left or we're just getting started in this category. And for us to have integrated so quickly with PeopleScout and interacting, that's good.

On the Staff Management side, one of your questions is, are we continuing to ramp up, and how's the existing accounts and new accounts growing? And bottom line there, they're both growing nicely. The existing accounts we have, we continue to expand our scope and take on more sites for those accounts. And we're continuing to win at the RFP level at Staff Management. So we're encouraged by both aspects, that existing accounts are buying more and we're still finding more customers there. That's exciting.

Over on the RPO, the PeopleScout, the level of RFP activity is increasing. The number of large customers that are turning to outsource their recruiting and sourcing needs is expanding faster than any other avenue or any other aspect of the human capital space.

And here in North America especially, we're participating in winning our fair share of those RFPs that are coming to play.

Our big strategic initiative here, our "push," which won't come in just one quick quarter, dang it, is to build the worldwide capacity to serve this need that's growing. As we all know, these large customers that we're serving have operations around the world. And this tightening labor market and the need to find great talent in the right spot at the right time -- that demand exists around the world.

The level of global RFPs that are starting to appear is growing. And we have a great operation down in Australia that can help service the PacAsia rim. And from North America, we can serve Europe. However, we feel like we need stronger teams and we're looking for an opportunity to actually build a larger operation in Europe and a larger operation in Asia around this, because that category's growing faster than any of the others.

Randy Reece - *Avondale Partners - Analyst*

Very good. Thank you very much.

Operator

We have no further questions. I will now turn the call back over to Mr. Steve Cooper for any closing remarks. Please proceed, sir.

Steve Cooper - *TrueBlue, Inc. - CEO*

Yes. Well, we appreciate you joining us on your busy afternoon here and to be able to update you on our strategies that we're working on here at TrueBlue. We remain really excited about the platforms that we're operating and the strategies that are behind that. And the results that are coming together of the investments we've made over the past two years are continuing to pay off. And we really are on the front end of something pretty exciting here. So thank you for joining us this afternoon.

Operator

This concludes today's conference. You may now disconnect. Have a great day, everyone.
