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TrueBlue, Inc. (TBI)

Q2 2016 Earnings Call

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Brent Navon
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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Mike, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 2016 TrueBlue Earnings Conference Call. [Operator Instructions]

I will now turn the call over to Derrek Gafford, TrueBlue's CFO. You may begin your conference.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

Good afternoon, everyone. Here with me is CEO Steve Cooper. Before I begin, I want to remind everyone that any forward-looking statements made by management during today's call are subject to the Safe Harbor statements found in TrueBlue's press release and SEC filings.

Any forward-looking statements in today's call speak only as of the date of which they are made, and we assume no obligation to update or revise any forward-looking statements. The company's second quarter earnings release and related financial information are available on TrueBlue's corporate website at www.trueblue.com under the Investor Relations section. This call is being recorded and a replay will be available on the company's website.

The discussion today contains non-GAAP measurements, including, but not limited to, adjusted net income, adjusted earnings per share and adjusted EBITDA. Adjusted net income excludes the following from net income or loss. Acquisition and integration costs, amortization of intangible assets, accretion expense related to acquisition earn-out, goodwill and intangible asset impairment charges, third-party processing fees associated with the Work Opportunity Tax Credit and also adjusts income taxes to our ongoing expected rate of 32%.

Adjusted net income and diluted shares are used to calculate adjusted EPS. Adjusted EBITDA further excludes depreciation, interest, and income taxes from adjusted net income. These are measurements used by management in assessing performance and, in our opinion, provide investors with additional insight on the underlying trends of the business. Please refer to the non-GAAP reconciliations on our Investor Relations website for a complete perspective of both current and historical periods.

I'll now turn the call over to Steve.

Steven C. Cooper

President, Chief Executive Officer & Director

Thank you, Derrek. Good afternoon, everyone. Today we reported our 2016 second quarter revenue grew 7% to $673 million. Adjusted EBITDA of $37 million was comparable to a year ago. Adjusted EBITDA for the quarter exceeded our expectations. Revenue trends continued to be mixed during the quarter, just as we saw in Q1. However, we managed and scaled our costs appropriately during the quarter and we are pleased with our teams who've continued to improve the spread between our bill rates and our pay rates.

We are definitely taking the right steps to preserve our profit margin and continue producing long-term growth for our shareholders. Our outlook for the third quarter includes adjusted EBITDA growth of approximately 20% on revenue growth of 6%. I'm pleased with the actions we have taken in our business this year that have put us in a position to provide an outlook of 20% adjusted EBITDA growth in Q3.

I want to share five areas impacting our results today and the outlook that we've provided. First, revenue trends are mixed with both some positives and some soft spots. Second, gross margin improvements, which relate to both the bill rate increases and positive business mix changes. Third, cost containment measures implemented this year to-date show our Q3 SG&A outlook more in line with our current revenue outlook. Fourth, the services provided to our largest customer have met or exceeded our revised expectations following the change in scope of services we announced in April of 2016. And fifth, the recent acquisitions are performing better than expected.

The first area that I'd like to cover. Revenue trends have been mixed with both some positives and some soft spots during the past few months. On a positive note, our Managed Services businesses or RPO, that's the recruitment process outsourcing and the MSP, which is our vendor management business, grew organically double digits in Q2. And our outlook includes continued organic growth in Q3.

In our Staffing Services businesses, we grew skilled construction straight double digits in Q2. And more specifically, we continue to see strong growth in residential construction along with manufacturing clients showing growth two quarters in a row now. And although organic revenue growth has slowed in our Staffing Services group as a whole, our small and mid size customers continue to grow at mid-single digits during the quarter.

Some of the soft spots we've seen this quarter include large accounts in our Staffing Services business with some slight declines. This includes the impact of the change in scope of services with our largest customer along with a couple of other large accounts that had significant declines due to the changes in their businesses. Excluding these accounts within Staffing Services, our overall organic growth would have been approximately 3%.

The outlook we have given today for revenue growth has been impacted by the mixed trends I've just discussed with you. Regarding our outlook, it remains promising that we have seen smaller accounts and our local accounts continuing to grow, and in particular, residential construction continues to perform well. The decline in our larger accounts seems to be a pause in project-based work, such as remodels and resets inside of retail stores rather than the general services related to ongoing support of retail sales, distribution and other ongoing positions in the areas of their business.

The second area I'd like to cover is gross margins. The improvement related to both the bill rate improvement and positive business mix changes are improving our overall profitability and profit margins. Our gross margins improved overall by 100 basis points this quarter compared to prior year. The improvement was primarily due to the impact of investing in higher gross margin acquisitions the past year in comparison to our blended company average and also the growth of our construction services, which produced higher gross margins.

We have also continued to make improvement in the spread between our bill rate and pay rates. The current environment, which combines slightly slowing demand with rising labor costs, has created some sensitivity in pricing compared to a year ago. However, in Q2 compared to Q1, we made great improvement in getting our target markup rates passed through.

The third area, cost containment measures implemented year-to-date now show our Q3 SG&A outlook more in line with the current revenue outlook. During 2015, we made significant investments by adding local sales and recruiting professionals in several markets, which helped produce the organic revenue surge at the end of 2015 and the specific growth we are seeing here in 2016. About $8 million of the increase in SG&A in Q2 compared to a year ago is related to these investments along with the variable costs related to supporting higher organic revenue and $10 million of the increase is related to the new acquisitions in the past year.

We mentioned on our Q1 call that with the slowdown in growth during the current year, cost containment programs have been commenced. We have selectively cut our costs, which some have already shown up in our Q2 results and many others showing up in our Q3 outlook. On a year-over-year basis, in our Q2, our SG&A percentage of revenue was up 150 basis points. With our cost containment now in place, our SG&A as a percentage of revenue will be back to being comparable to prior year.

Our fourth area, services for our largest customer have met or exceeded our revised expectations following the changes in scope of service we announced in April. In April, we were notified by Amazon of their intent to shift our scope of services over the next year. This shift is to assist them with their highest growth segment of their delivery system as they ramp up more local delivery systems over the next few years.

We are slightly ahead of our expectations with our adjusted level of service with Amazon, which is a result of our continued good service and partnership that exists. We expect this account will grow in 2017 beyond the outlook for 2016, and as they execute their strategy, we expect growth beyond 2017 in connection with this shift.

Our fifth area, our recent acquisitions of SIMOS and Aon's RPO business are performing better than we expected them to at the date of acquisition. On December 1, 2015, we acquired SIMOS Insourcing Solutions, a leading provider of on-premise workforce management solutions. They specialize in helping clients streamline warehouse and distribution operations to meet the growing demand for online commerce and supply chain solutions. This has been a strategic move on our on-premise teams, as we see many new opportunities to infuse our current operations for clients with these special services.

On January 4, 2016, we acquired Aon Hewitt's RPO services. These acquired operations expand and complement our PeopleScout services and have quickly been fully integrated with our PeopleScout service line here in 2016. Innovations within our company along with additional acquisitions combined well with our existing business to put us in a strong position for the future to be the leader of talent solutions. We believe the RPO market has tremendous potential on a worldwide scale, which is why we are so pleased we could bring the Aon Hewitt RPO operations into our PeopleScout brand here in 2016.

Hopefully, these five areas of our business and our outlook will be helpful to you, as you can see our core business remained strong and should provide expanding margins as we execute the actions mentioned here today. Our top priority remains to produce strong organic revenue growth across all aspects of our business and leverage our cost structure to generate increasing EBITDA margins. We believe these steps outlined here today put us on track to do just that.

Acquisitions have been a key element of our growth strategy. Improving shareholder returns through ramping up the most current acquisitions along with sourcing, acquiring and integrating additional companies will remain a focus for our team. Although we disclosed today a non-cash impairment charge related to acquired businesses, which was primarily associated with the change in scope of services with our largest account, we strongly believe these acquisitions have provided and will continue to provide shareholder growth and returns.

We have heard time and time again from our current customers and prospective customers that they will need to rely on experts like us for strategic workforce management and recruiting. Our business is built on the premise of making it easier for our customers to grow their businesses. We do this by helping them adjust their workforce needs to their business strategies. Although we have seen a few changes resulting from large accounts adjusting their current needs, these customers continue to thrive and we continue to have relevant relationships with them. They appreciate our business model in times of contraction and we – and really appreciate it in times of expansion. We will continue to be viable and relevant to each and every customer during times of softness and times of growth.

From our outlook today, you can see our adjusted EBITDA margins have remained strong, and we anticipate further expansion beyond this year.

I will now turn the call over to CFO, Derrek Gafford, for further analysis and details on our results and outlook, Derrek?

Derrek L. Gafford

Executive Vice President & Chief Financial Officer

Thanks, Steve. I'll start off by giving an overview of the key aspects of our results this quarter and then provide additional color on our operating trends. Net loss was $64 million for the quarter. Included in our results is a non-cash goodwill and intangible asset impairment charge of $99 million, which is equivalent to $80 million net of tax or $1.91 per share. $67 million of the pre-tax charge is within the staff management reporting unit related to a change in scope of services with our largest customer, which was reported by TrueBlue in April 2016. The remaining impairment charge occurred within the PlaneTechs and HRX reporting units in connection with outlook changes, reflecting recent economic and industry trends.

Adjusted EBITDA of $37 million was above the upper end of our previous outlook while total revenue growth of 7% was near the low end of our previous outlook. Strong progress on the spread between bill and pay rates kept total gross profit dollars toward the midpoint of our previous outlook. And disciplined cost management further contributed to adjusted EBITDA results.

These actions help position us for adjusted EBITDA growth and margin expansion in Q3 this year, which I'll cover later in my discussion, versus the flat growth and 50 basis points of margin contraction in Q2 this year. Total revenue grew by 7% while organic revenue declined by 1%. Excluding our largest customer, organic revenue grew by 2%.

Staffing Services continued to experience a moderate pace of demand, while Managed Services delivered another strong set of results. Revenue for the Staffing Services segment was up 4% or down 2% on an organic basis. Revenue with our largest customer was down versus prior year but met our expectation for the quarter.

Excluding our largest customer, organic revenue grew by 1% in Staffing Services. Revenue growth for the Staffing Services segment were mixed for the quarter. Trend softened on the West Coast and in the Northeast while we saw improvements in the Southeast and Southwest, with steady results in the Midwest. Construction and transportation industry trends were more moderate and retail weakened while manufacturing continued to improve.

Revenue from the SIMOS acquisition was lower than expected from a slower rollout pace with a couple of customers. However, as we enter the third quarter, new customer rollouts are ramping as expected.

Turning to Managed Services, revenue was up 76% or low-double digit on an organic basis. Contributing to the strong results were additional projects in the legacy RPO business and same customer volume increases in the acquired RPO business.

Now I'll give some background on operating trends impacting our profitability. Gross margin of 25.3% was 110 basis points higher than Q2 last year. Approximately 120 basis points of expansion is from favorable impact of our recent acquisitions, which carry a higher gross margin than the company average, and from positive sales mix within the organic business. Excluding these items, gross margin declined 10 basis points, which is an improvement compared to the decline of 50 basis points reported in Q1 this year. Our teams continue to make good progress managing the spread between customer bill rates and contingent employee pay rates.

SG&A as a percentage of revenue was 20.2% or nearly 150 basis points higher than the same quarter a year ago, primarily from higher cost in the organic business. On a dollar basis, SG&A was $136 million, up $18 million compared to Q2 last year. $10 million of the increase is from ongoing operating costs associated with the acquired businesses and $8 million in the organic business from investments made in 2015.

The effective income tax rate was a benefit of 18% this quarter, lower than our ongoing expectation of about 32% due to permanently non-deductible items associated with the impairment charge. Excluding the impact of the impairment charge and the related non-deductible items, the income tax rate was in line with expectation.

Turning to the balance sheet, Q2 finished with $150 million of total debt, $16 million less than Q1 2016. Total liquidity defined as cash plus borrowing availability on the revolving credit facility was $149 million. Year-to-date cash flow from operations was exceptionally strong at $184 million, nearly $80 million higher than the same period last year, primarily due to accounts receivable deleveraging. Accounts receivable hit a historic peak in Q4 2015 from it being a record revenue quarter as well as a higher days sales outstanding metric, which has since dropped to a comparable level with the prior year.

Looking ahead to the third quarter, the outlook for total revenue growth is about 5% to 7%; 3% to 5% for Staffing Services and 50% to 60% for Managed Services. The outlook for net income is $24 million to $26 million and earnings per diluted share of $0.57 to $0.62 or $0.73 to $0.78 on an adjusted basis. The outlook for adjusted EBITDA is $51 million to $54 million, representing growth of roughly 20% or 80 basis points of margin expansion in comparison with Q3 last year.

Profitable organic growth is our top priority, and we're taking the right steps to manage through a choppy demand environment. Ensuring our bill rates are priced properly and our operating costs are managed in a disciplined manner continue to be key focus areas for us as we manage the year ahead.

That ends our prepared remarks for today. We can now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question is from Jeff Silber from BMO Capital Markets.

Jeffrey Marc Silber
BMO Capital Markets (United States)

Q

Thank you so much. Last quarter you provided annual guidance. I'm wondering if you can revisit that. Are you still comfortable with what you gave us last quarter?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Hi, good afternoon, Jeff. Yeah, we're not making any update to guidance this quarter. We did update it last quarter because of the event with Amazon. Our intentions weren't originally to update that guidance, and we just felt that we needed to last quarter because of that event, and we're going back to giving quarterly guidance. So, no reaffirmation of that guidance today.

Jeffrey Marc Silber
BMO Capital Markets (United States)

Q

Okay. Understand. Can you talk about monthly trends in your two divisions? And any color you can give us on how things are going on in July so far would be great. Thanks.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Sure. It was, in our Staffing Services group, if we just take a look through the quarter, there wasn't much inflection point in those organic revenue trends that we just shared. It was pretty steady state at least on an aggregate basis. Certainly different things going on in different geographies, but pretty steady state on a monthly trend basis. And really the same went for the Managed Services group. Now, the guidance that we've given overall today is pretty close with the results that we gave, that we reported here in Q2. So the outlook that we've got coming to July is really directionally in alignment with results we just reported and very consistent with the guidance that we've given for the third quarter.

Jeffrey Marc Silber
BMO Capital Markets (United States)

Q

Okay, great. That's helpful. And then just a couple of numbers questions. What share count is embedded in your 3Q EPS guidance and what should we be modeling for capital spending for the year? Thanks so much.

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Yeah. Share count will be a little under 42 million, call it 41.8 million-ish. And CapEx, we're looking at $5 million-ish for Q3, which is really about the pace that we've been on, as we've moved through the first half of the year.

Jeffrey Marc Silber
BMO Capital Markets (United States)
Q

Okay, great. Thanks so much.

Operator: The next question is from Randy Reece from Avondale partners.

Randle Glenn Reece
Avondale Partners LLC
Q

Afternoon.

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

Afternoon, Randy.

Randle Glenn Reece
Avondale Partners LLC
Q

First of all, I wanted to check on the impairment. It seemed like you had some cushion at the end of last year as far as the goodwill value on PlaneTechs. So I'm just wondering what happened in the first half of this year that led to an impairment.

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

Sure. Well, PlaneTechs has been one that we've been disclosing in the SEC filings. While that's been in there most consistently, there might have been a year here or there that it wasn't as far as the headroom being less than 20%. And when you say cushion, I'm referring to headroom, that's in regard to the assessment of what the enterprise value is at that point in time and in comparison with the current value of the assets on the books in that comparison. Really the thing with PlaneTechs is PlaneTechs has been running in the $90 million-ish of revenue range, and seems like each quarter, each year we've had a larger project generally tied to somehow to Boeing, and as we enter this year, there's just not any really projects in that division.

And so year-to-date, we're running beneath where we were last year in our own forecast. We're talking maybe about $10 million or $15 million less than we did last year. That's in our – no change in our run rates to the first two quarters, but as we took a look at the outlook for the rest of the year combined with where we stand at the middle of the year, that seemed appropriate to make an assumption that's going to be the trend for this year and at least in our modeling out into the future with a mild growth rate.

Steven C. Cooper
President, Chief Executive Officer & Director
A

No real changes, Randy, there in the operation, and we're still set to ramp up and do those projects. We just don't have one currently in place and that really changed the way that valuation looked.

Randle Glenn Reece
Avondale Partners LLC
Q

Okay. And did the – was there a significant difference in revenue versus expectations in the regular staffing lines versus the outsourced workforce management business in the second quarter?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Yeah. The – we were – overall the company was about – down about maybe at the lower port of our guidance range. So maybe $10 million less than had we been talking about the midpoint of the range earlier. A little bit more than that in Staffing Services because Managed Services came in better. If you break that down a bit, really the organic piece of the on-premise business came in really right as we would expect it. I talked about SIMOS, our acquisition being down a little bit because of some customer implementations, but nothing to read into there. And then the rest of the business is really filling that gap in our branch-based business in a bit softer. That's the primary reason that the growth came in a point or two less this quarter.

Randle Glenn Reece
Avondale Partners LLC

Q

You consolidated some branches this quarter, and in the past, you've had some concerns I guess about losing and having some revenue leakage whenever you consolidated branches. Have you done anything strategically or tactically to kind of forestall that potential?

Steven C. Cooper
President, Chief Executive Officer & Director

A

Yeah. We haven't consolidated very many, and we're still going to be careful. There is – it's really technology-driven and adding recruiters are the two things that give us the confidence to consolidate branches. Overall, we're combining teams to work in larger groups and units to cover for each other. And so if there is an area that has three branches that have been working together, there might have been some confidence that the recruiting efforts are strong enough out in the nearby branches that a branch could be consolidated.

Really going forward, the way we're looking at it is, is if we have other methods to find – do our recruiting and find our people that the branch would be the least preferable. And so, as we bring on our new technology and our mobile app late here in 2016 and we see it running well in 2017, that could be a large driver of consolidations. And we're seeing great results where that's up and running and the amount of reach that it has to pull people out of the market without having to come to a branch. So that's our thought process there, as – if we can limit the traffic inside of a branch, then we can consolidate the team and really recruit a different kind of person in our team to do the work, less transactional and more professional recruiting and meeting the needs of the customers.

Randle Glenn Reece
Avondale Partners LLC

Q

Do you have a feel or an actual number for how much of the country you're covering with your, let's say, mobile model?

Steven C. Cooper
President, Chief Executive Officer & Director

A

Yeah. I really don't – it's up and running well in 30 branches, and another 30, we got to start it, but we had a little bit of a delay here this quarter to ensure that it's scalable and that we don't get out there and then people get frustrated with the speed. So we've had just a little bit of a slowdown here to ensure the speed's right, but there is no long-term trouble there. It will be up and running by the end of the fourth quarter.

Randle Glenn Reece
Avondale Partners LLC

Q

Very good.

Steven C. Cooper
President, Chief Executive Officer & Director

A

I'll have more to share with you definitely as we go into the first quarter.

Randle Glenn Reece
Avondale Partners LLC

Q

Great. Thank you very much.

Operator: The next question is from Mark Marcon from R.W. Baird.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)

Q

Good afternoon. I was wondering if you could talk a little bit about some of the regional differences that you saw. Like, to what extent are they driven by some of the overall vertical trends that you mentioned as opposed to something that might be specifically occurring in those markets? So when you mentioned the Northeast and the West slowing, what exactly is driving that?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Well, I think a piece of what's going on on the West Coast that we're seeing is – and we saw this the last time and then weighed them into FX. So this is largely being driven by California, a little bit of softness in Washington State, but when – minimum wage went into effect this year. Really that's moving the pay rate up and the associated burden costs by, let's call it, 15%, pretty large increase for employers.

When we went through the same exercise in the middle of 2014, we saw about six months worth of revenue trends. Whatever growth rate we were on had some level of deceleration in them. So we've seen that again here for the first six months of – with California. I mean, you could pretty much say minimum wage went into effect at this point in time and then lay the two lines of the revenue trends over one another, and they look almost identical. The really question is what happens as we go into Q3? And months seven through nine, when we did this through with California, we started seeing bounce. I mean, a revenue trend starting to inflect upwards from its previous trend. And I suspect that's – we'll see something similar here as we work through that this time around.

The Southeast and Southwest have been different stories for us that the Southeast had just stayed nice and steady for us, mid-single digit, upper-single digit, in some areas double-digit. The Southwest – and Texas is more – probably a little bit more a story of recovering from some drop-off from energy. If we were talking about the Southwest for us, primarily Texas, we were probably down about 15% year-over-year in the third quarter, and each quarter, that says we've anniversaried those comps, those – that's – that decline has gotten less and less and then we've emerged into growth as we ended this quarter and came into the third quarter. So that's a little bit of color around those trends.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)

Q

Great. And the Northeast, is that the same sort of dynamic as the West Coast or was it something different?

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

I think that one has been a bit different. When I'm talking about it weakening, it's not that it's dropping off, but we had some very, very strong growth. Still have good growth there, particularly in skill trades. It's more just about an inflection of it not being as high as it used to be. So it's not an overly weak area for us. It's actually performing at a pretty decent level. It's just not at the same level of growth that it was before. So I don't know that there is a real call-out there, Mark.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)
Q

Okay, great, Derrek. And with regards to Amazon, you mentioned that it's going to do a little bit better than your revised expectations. Can you give a little more color there in terms of exactly what's going on in the ground and how materially different the results or your expectations are now relative to at the end of the last quarter for the balance of the year?

Steven C. Cooper
President, Chief Executive Officer & Director
A

Yeah. It's not material, but it's, what's the nice part is, is they're doing what they said they would do, and we're participating at those levels. It's the materiality that might be that we're six months ahead of where we thought we'd be. And so we really haven't adjusted our outlook based on these trends, but it's nice to see that the expectations that we gave in April are that they weren't unreasonable and that this account is going to go forward from here and that it was just truly some adjustments with strategy and not something deeper there. So that's the most important part about that. That news is the relationship is sound. They're moving forward. We're hitting their new expectations. They're moving quickly on their new strategies, and we're performing well on that.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)
Q

So, are you seeing some of those local distribution centers really pick up at this point?

Steven C. Cooper
President, Chief Executive Officer & Director
A

Yes, they're ramping them up fairly fast. And it's delivery stations is what they call them, and they intend to use more and more of those so they can get the delivery down and control it on their timeframe.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)
Q

How big is that becoming for you at this point?

Steven C. Cooper
President, Chief Executive Officer & Director
A

Well, we are anticipating it to be about a $50 million run rate by the time we got to next. To hold that $200 million forecast up, we needed about $50 million in that business. So we're on track to be able to perform at that level, a little bit ahead of it right now.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)

Q

That's great to hear. And then with regards to the adjustments in terms of the expenses, you mentioned you've realized some of them but not all of them. What's the expectation with regards to absolute SG&A sequentially as we think about that for Q3?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Yeah, we made a lot of good adjustments really across the business here. So let me hit the bigger picture and then I'll drop down to answer your question specifically, Mark. What we're really trying to do is to take an approach here on managing this market-by-market. We got some markets that are growing great. And in those areas where we need to actually investing some resources there and then others where it's either we're not performing there, particularly if we're not performing in the market conditions there coupled with our own performance is it don't look attractive scaling back our resources there.

So, and so that's on a market-by-market. Most of that is from a people perspective. Our field organization since the beginning of the year, the totality of this is we've scaled back about 150 positions even as revenue has ramped a bit. So that's primarily what's driving an increase here. This is excluding any adjustments that we've made from a head count perspective related to the Amazon business. The numbers are a little bit bigger there, but all of that was in our prior forecast and things that we shared with you. Outside of that, we're making a variety of other adjustments really across the business, whether it be vendor spends, consolidations of vendor spends and other things to bring in some efficiencies, but really the main thing here is managing our field personnel head count, which is the main driver of expense.

If we talk about SG&A on a total dollar amount and look forward to really what's implied in our guidance, we're talking about the SG&A increase of a little north year-over-year of $10 million, I don't know, call it $12 million, $13 million, $14 million. Really what that all is, is we got $10 million of SG&A in there that's just from the operations of acquisitions that we've done. And then you've got another, we got another $3 million or so in there of costs related for integration efforts related to the acquired Aon Hewitt RPO business.

So if you strip all that away and talk about what we're talking about on a organic basis, we're really expecting it to be relatively flat with the prior year versus the $8 million or so increase on an organic basis that we had Q2 this year. So I think we've made the right adjustments across the board to position us well, scale our expense structure to where demand is, and at the same time, do it in a smart way that we're still very able to grow in the markets where we've got opportunities.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)

Q

Great. And last one, and then I'll jump back in the queue. Organic RPO business, it sounds like it picked up. Can you give a little color there in terms of, was it just – is it one or two big clients, was it unexpected, or what happened there?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Yeah. There's been a couple of different moving currents really within our organic RPO business. The acquired business has been doing very well. We'd actually expect some revenue attrition in that business. We've been holding all of that actually getting a bit of an uptick. So the acquisition has been performing really well.

In our organic business, there has been two different trends going on. One, we've been having actually some contraction with the few of our customers. So these are larger customers that's not anything that's been service-related, it's just their own level of demand, they've been cutting back. And so that's been dampening the sales trend to a certain degree. But the pipeline of new projects coming on has been – continue to be healthy. We're still continuing with some rollouts or some wins that we had in the prior year. And there's also been some nice project work coming in that's been powering that, which is nice not just for the quarterly results, but oftentimes these RPO engagements, they start with something small, they start with a project, and that's a foot in the door to expand to a larger project.

Mark S. Marcon
Robert W. Baird & Co., Inc. (Broker)

Q

Great. Thank you.

Operator: [Operator Instructions] The next question is from Sara Gubins from BOA Merrill Lynch.

Brent Navon
Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Hi, this is Brent Navon calling in for Sara. Thanks for taking the question. Getting back to guidance, your 3Q outlook calls for 3% to 5% growth in the Staffing Services on a reported basis. And what – what are those expectations on an organic basis? And then on top of that, you said in 2Q, organic growth declined by 2%, and excluding Amazon, it was up 1%. So that would imply about a $20 million drag from Amazon. What would that drag in 3Q be?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Yeah. The trend that we are talking about really for Staffing Services and our guidance is very similar to the revenue trend that you got today. And so, as we're going forward to the third quarter, the difference between total revenue growth – excuse me – organic growth with Amazon or a decline in this case and organic growth without, it's going to be a very similar spread to what it was here in the second quarter, which is about 3 points of drag overall really for the company and pretty close for the same for Staffing Services.

Brent Navon
Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Okay. Thanks. And then last quarter you also you mentioned some difficulty in passing on minimum wage increases and marking up, and I think in your prepared remarks you said you were able to do that a little bit. I mean, how far along are you in that, and do you expect to see more benefit in the next quarter from that?

Derrek L. Gafford
Executive Vice President & Chief Financial Officer

A

Well, we're not all the way finished. We still got more work to do. I think really the message that we're talking about today is we had had a plan really to – from a trajectory perspective, to diminish that each quarter, as we move through the year. To give you some perspective, the gap between our bill and pay rates – so I'm talking about what the inflation rate is year-over-year and our bill rates in the inflation rate, what it was in our pay rates, and then measuring the gap between the two. That was about 170 basis points in Q1, meaning that the pay rates were rising 170 basis points faster than bill rates. And we got that down – that gap down to almost about 1%, slightly north of that. So let's say we chop it down into about a third. So we are – let's say, we're three innings through the baseball game here and another six to go.

Brent Navon
Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Great. Thank you so much for the color.

Operator: There are no additional questions at this time. I will now turn the call back over to Steve Cooper for closing remarks.

Steven C. Cooper
President, Chief Executive Officer & Director

Great. Hey, we appreciate you being with us today, and we'll look forward to talk you next quarter.

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