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TrueBlue, Inc. (TBI)

Q3 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Chantelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the Q3 2016 TrueBlue Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

Thank you. Derrek Gafford, CFO of TrueBlue, you may begin your conference.

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

Good afternoon, everyone. 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, and speak only as of the date on which they are made. We assume no obligation to update or revise any forward-looking statements.

The company's third quarter earnings release and related financial information are available on TrueBlue's 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 EBITDA, adjusted EBITDA, adjusted net income, and adjusted net income per share. EBITDA excludes from net income interest, taxes, depreciation and amortization. Adjusted EBITDA further excludes from EBITDA costs related to acquisitions and integration, goodwill and intangible asset impairment charges, other charges and Work Opportunity Tax Credit processing fees.

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Adjusted net income excludes from net income the adjustments noted in adjusted EBITDA, except for depreciation and adjust income taxes to the expected ongoing effective tax rate. Adjusted net income and diluted shares are used to calculate adjusted EPS. These are key measures used by management to assess performance, and in our opinion, enhance comparability and provide investors with useful insight into the underlying trends of the business.

Please refer to the non-GAAP reconciliations on our Investor Relations website for a complete perspective on both current and historical periods. Any comparisons made today are based on the comparison to the same period in the prior year, unless stated otherwise.

I'll now turn the call over to Steve.

Steven C. Cooper

Chief Executive Officer & Director, TrueBlue, Inc.

Thank you, Derrek, and good afternoon, everyone. Today we announced results for the third quarter of 2016, with revenue growth of 2% and net income growth of 17%. Adjusted net income grew 17% to $0.70 per diluted share. Our team delivered growth in revenue and net income this quarter, while sustaining a high-level of service quality with our customers.

Given the challenging environment with regard to growth, we have maintained a sharp focus on the pricing of our business and management of our operating expenses. Our expense management actions have been decisive and balanced, as we remained committed to our long-term technology and growth strategies. We are taking the right steps to preserve our profitability, while maintaining our readiness to accelerate growth. This focus, along with the performance of our recent acquisitions, produced 70 basis points of adjusted EBITDA margin expansion this quarter compared to a year ago.

I will discuss five areas with you that had an impact on the results this quarter. First, the operating environment has been difficult; second, our disciplined approach to pricing and expense management; third, the status of our services with Amazon, our largest customer; fourth, changes to our branding structure; and fifth, the successful performance of our recent acquisitions.

First, the operating environment has been difficult and negatively impacted the quarter. Our organic revenue, excluding Amazon, declined 3% in Q3. As the quarter developed, our organic revenue trends excluding Amazon worsened, with July being flat, August down 3%, and September down 5%. National accounts have declined to a larger extent than our local accounts. Amazon and just a few other large accounts were the primary driver of the overall decline, whereas our local accounts remained close to flat compared to the prior year same quarter.

We did have a large acquisition in our Managed Services segment, which has created close to 60% growth there along with our organic revenue in this segment growing mid-single-digits. Adjusted EBITDA dollars and margins for Managed Services doubled as compared to prior year. Derrek will cover certain industry and geography trends with you in his remarks.

The second area of discussion, our disciplined approach to pricing and expense management has positively impacted the quarter. The low to no growth economic environment, along with rising wage costs, have created some pressure on our gross margins during 2016.

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We have remained disciplined on this front and have continued to experience improving trends as the year has developed. Excluding the impact of acquisitions and sales mix, gross margin improved this quarter to be up 10 basis points, as compared to the same quarter a year ago, whereas we had seen 50 basis points of degradation in Q1 earlier this year.

We've also taken several cost reduction actions, which have been decisive and balanced. Resources are continuously assessed on market-by-market basis, while remaining committed to our technology and long-term growth strategies. Excluding the additional expense from acquired businesses and unique costs during the quarter, organic expense was down 5%.

The third area of discussion, the status of our services with Amazon, our largest customer. Amazon has been a significant customer in our Staff Management brand, which provides on-premise staffing solutions. We have provided services in two aspects of Amazon's workforce.

The first being large scale fulfillment centers. Here we provide contingent labor throughout the year, with our primary value being to help the huge seasonal ramp from September to December. This service represented approximately 13% of our revenue in 2005. As discussed earlier this year, Amazon plans to in-source most of this work within the U.S. and we reduced our outlook accordingly at the end of the second quarter.

The second service we provide to Amazon is labor within their delivery stations. While this business only makes up $35 million of year-to-date revenue, it was expected to grow significantly. Although we had disclosed and forecast in our outlook that we would continue to be the provider for this part of Amazon's workforce, it has become evident, as part of a broader strategy, to be more self-sufficient that Amazon will be directly sourcing the workforce needs for these locations and not requiring our services for the delivery stations.

Derrek will provide with you more information on our historical and expected results related to our outlook for these services. While this is clearly disappointing news, the profitability of this business has become a challenge, dropping from an adjusted EBITDA margin of over 7% last year to 4% this year. The revenue drop with this customer shouldn't overshadow the success of our on-premise business and our Staff Management brand. Excluding the Amazon impact, revenue grew by 7% this quarter at Staff Management.

The fourth area of discussion, changes to our branding structure. We have recently announced the simplification of our go-to-market branding approach for our specialized staffing solutions. This is the culmination of efforts that have been underway for quite some time. The dynamics in the marketplace have been changing, and businesses have come to expect our service capability to broaden in each and every brand.

Customers want our services to deliver an increasingly wide range of talent. We've had three brands that all deliver specialized, yet similar talent and labor solutions. And many times we have multiple brands calling on the same customers, creating overlapping operating costs for us and frustration on the customer's part to have to deal with three different teams.

We are streamlining our three branch-based staffing brands, Labor Ready, CLP and Spartan into one brand, PeopleReady. As previously disclosed, we have been working on this consolidation for quite some time to ensure that the following things happen: our services expand as a result of this combination, our customers and the workforce we place and manage each day do not miss a beat, and our customers find it easier to do business with us and are ultimately able to rely on PeopleReady for even more services.

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Our expenses this quarter include a $4 million non-cash intangible asset impairment related to the write-off of CLP and Spartan brand names, and a $2 million write-off of branch signs associated with dissolving the brand names. Earlier this year, we rebranded all of our RPO businesses into the PeopleScout brand. This now provides us with two strong brands of PeopleReady and PeopleScout.

And the fifth and final discussion area, the successful performance of our recent acquisitions. At the end of 2015 we acquired SIMOS, and at the beginning of 2016 we acquired Aon Hewitt's RPO service line. These two recent acquisitions are on pace to exceed our original EBITDA expectations. We now expect these two acquisitions to generate approximately $33 million of EBITDA as compared to our earlier expectation of $26 million.

SIMOS has been a great addition to our workforce management solutions. SIMOS's unique productivity model delivers a strong value proposition for the clients, and we've seen outstanding employee and client retention since the acquisition. We've also seen nice expansion of the service and we are excited about continuing to build on the success of this growth.

Likewise, we've been very pleased with the performance of our Aon Hewitt RPO service line acquisition. The integration into our PeopleScout brand has gone very well and is nearly complete. We are excited about the continued growth prospects domestically, as well as furthering our international growth plan to drive business growth in our RPO solutions.

We maintain our commitment on being the best at industrial staffing and recruitment process outsourcing, which makes it easier for our customers to adjust their workforces in response to changing economic conditions. Although we've seen a recent slowdown in our results, we remain optimistic, as this is the very value we bring to our customers, the ability for them to flex their business growth and strategies, no matter what point in a business cycle they might be. We can help them ramp-up quickly in periods of growth and help them control their costs quickly and shift their workforce in times such as this. We remain very excited about the future and understand what it takes to succeed in all different types of market conditions.

I'll now turn the call over to our CFO, Derrek Gafford, for further details on our Q3 results and our fourth quarter outlook. Derrek?

Derrek L. Gafford

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

Thanks, Steve. I'll begin with an overview of our financial results for the quarter, and then add some color on our operating performance by segment. I'll then discuss our liquidity position, outline our financial outlook, and finish off by covering our acquisition and capital management strategies.

Total revenue increased by 2% and organic revenue declined by 6%, or a decline of 3% excluding Amazon. Net income grew by 17% and adjusted EBITDA improved by 12%. I want to provide some color upfront on the revenue and EBITDA contribution from Amazon.

First, in regards to the delivery business we exited in Q3, year-to-date revenue for that business is about $35 million, with $3 million of start-up losses. Second, I'll provide a total revenue and an EBITDA set of trends for this customer. In 2015, revenue was $355 million and EBITDA was $24 million. Revenue for 2016 is expected to be $165 million, and excluding $2 million of costs associated with the exit of the delivery business, 2016 EBITDA is expected to be $7 million.

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Looking forward, the annual run rate is expected to be about $30 million of revenue, or 1% of total company revenue, and $2 million of EBITDA. Additional details including quarterly data can be found in our earnings release deck issued today.

While we continue to pursue large customer opportunities, the Amazon relationship was an isolated concentration of revenue. Our next three largest customers each represent 2% of total company revenue and none of our remaining customers represent more than 1% of total company revenue.

Turning back to quarterly results, total revenue of $697 million was below the bottom end of our expectation. Organic results, excluding Amazon, for July were flat and in line with expectation. August results declined by 3% and September further softened to a decline of 5%. The lower than expected revenue offset by better gross margin and expense results produced adjusted net income per share of $0.70, which was $0.03 below the bottom end of our expectations.

Gross margin was up 90 basis points, with the improvement roughly split between a favorable impact of acquisitions that carry a higher gross margin than the legacy business and favorable changes in sales mix within the organic business. Put another way, excluding acquisitions and mix, fundamental gross margin was roughly flat compared to Q3 last year, which is a marked improvement from Q1 this year, when fundamental gross margin was down 50 basis points.

Operating expenses were up $10 million, which includes $11 million of ongoing operating expense from acquired businesses and $5 million of expense associated with fixed asset write-offs related to the branding change, exit costs associated with the Amazon delivery business, and planned integration costs associated with the RPO business acquired in Q1 this year. Excluding the $16 million of expense, operating expense dropped by $6 million, or a decline of about 5%.

Reflected on a separate line item in the statement of cash – excuse me, in the statement of operations was a non-cash intangible asset impairment charge of $4 million from the write-off of the CLP and Spartan trade names associated with the branding transition. The effective income tax rate was 13%, lower than our expected ongoing rate of 32% due to a higher yield on prior year Worker Opportunity Tax Credits.

Next I'll provide some background on the operating performance of our segments. Revenue for Staffing Services was down 1%. On an organic basis, revenue was down 7%, or down 3% excluding Amazon. Revenue trends moderated across most lines of business. Residential construction grew in the mid-teens, with non-residential construction experiencing a mid-single-digit decline.

Excluding Amazon, retail revenue was down about 10%, consistent with the trend in Q2. Transportation was down high-single-digit and manufacturing down low-single-digit, both of which were roughly consistent with the trend in Q2 this year.

Revenue from customers in service-based industries was slightly negative versus high-single-digit growth in Q2 this year. Adjusted EBITDA was down 7% and related margin was down 50 basis points, as the organic revenue decline slightly outpaced the decline in operating expense.

Turning to Managed Services, total revenue grew over 60%, led by the additional revenue from the RPO acquisition completed earlier this year. Organic revenue also grew and grew at a pace of 5%, which was the net result of two underlying trends. Existing customer volume declined from a tighter pace of hiring activity, but was more than offset by new deal volume. We believe the current environment provides net revenue growth

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opportunities from competitive takeaways and new first-time RPO customers. But we also expect lumpiness in quarterly trends due to the smaller customer base in this segment in comparison with the Staffing Services segment.

Adjusted EBITDA and related margin both doubled. The growth was the result of customer pricing and cost improvements made within the legacy business this year, as well as the acquisition of the Aon Hewitt RPO business and related synergies.

Our balance sheet remained strong, given our solid cash flow and moderate level of debt. Year-to-date cash flow from operations was $213 million, or $93 million more than the same period last year, enabling us to make great progress in reducing debt. Debt-to-total capital dropped from 31% in Q4 2015 to 21% in Q3 this year, putting our trailing adjusted EBITDA as a multiple of total debt at less than one turn.

For the fourth quarter, the outlook for total revenue growth on a 13-week basis is a decline of 15% to 17%. On an organic basis excluding Amazon, the outlook is a decline of 5% to 8%, which is a deceleration from the 3% posted in Q3 this year, largely due to tougher prior-year comparisons in Q4 last year versus Q3 last year.

To be more specific, organic revenue growth in Q4 last year excluding Amazon was 11% versus 6% in Q3 last year. The comparison gets easier as we move into 2017, as the Q1 2016 comparison is 4%. The outlook for net income is $17 million to $19 million, and for earnings per diluted share of $0.40 to $0.45, or $0.54 to $0.59 on an adjusted basis. The outlook for adjusted EBITDA is $38 million to $41 million, representing a drop of roughly 15%. Excluding Amazon, adjusted EBITDA is expected to be up about 5%.

Let's shift the discussion to our year-end. We expect the extra nine days associated with the extra week this year and the planned change in our week-ending date to produce about $30 million of revenue. Since this is our lowest revenue volume week, the additional gross profit dollars are expected to be breakeven with the operating expense for this period. Additional details on the outlook for the fourth quarter, including our segments, can be found in our press release financials and earnings release deck filed today and posted on our website.

I'll finish off here with a discussion on our acquisition and capital management strategies. Over the course of completing more than 20 acquisitions, we have developed a rigorous acquisition process, which includes a disciplined return on investment methodology. Our return on investment threshold is 20%, which is comprised of our cost of capital at 12%, plus a risk premium of 8%. Buying at smart valuation levels is an important part of the process. Our last two acquisitions were purchased at an average of less than five times forward EBITDA. We will continue to be opportunistic in this space, but we also recognize the current low growth environment and necessity of a very disciplined approach.

Let me also share a few points on our capital strategy. Over the most recent years, capital has been deployed to fund accretive acquisitions. We have used a mix of cash and debt to fund this strategy, to boost return on equity, while maintaining a debt-to-EBITDA multiple in the range of one turn to two turns.

Over the course of a full economic cycle, share buybacks remain an important part of our capital management strategy and had a positive impact on our long-term returns on invested capital. Currently, we have $35 million of stock buybacks authorized. We will continue to allocate capital to the opportunities that will generate the best return on invested capital.

Over our nearly 30-year history in the human capital space, we've developed a seasoned approach to manage the business through various cycles. We have taken the right steps in a low growth environment to preserve our

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profit margins, while investing in strategies to help prepare the business to outperform the market as higher levels of demand return.

That concludes our prepared comments. We can now open the call for questions.

QUESTION AND ANSWER SECTION

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

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)
Q

Thank you so much. I wanted to ask about the intra-quarter trends, the decelerating trends from July to September. There was a lot of anecdotal and economic data that actually showed things improved throughout the quarter. I know sometimes that data is misleading. But I'm just wondering what you think happened specifically, especially compared to where we were at the beginning of the quarter? Thanks.

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.
A

Yeah. Those were gradual, but they were consistent going from flat to 5% organic fall-off. And it's interesting, Jeff, when you compare it to economic data, the timing is not exact of when manufacturing jobs might take a downtick or an uptick and same with some of the construction job activity that happened during the quarter. But we definitely see it over time. It may be off by a couple of weeks, it might be off by as much as a month, but what's reflected in the temporary help numbers and especially our most industrial short-term project numbers happens quickly. When those other numbers drop, our numbers drop. And again, there might be a two-week or three-week lead way or tail-off as those numbers move. They're not always exact.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)
Q

And you specifically decided some weakness in the other national accounts besides Amazon. Can you give us a little bit more color what was going on there?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.
A

Yes. There were some fairly big projects in the fourth quarter that drove some of those numbers, and it started towards the tail end of the third quarter last year and that drove some of it, for sure. But in general, we've seen larger accounts being more cautious all of 2016 and the hiring in small accounts still continue to be at not a brisk pace, but an acceptable pace on small accounts.

We've seen that both from our temporary help contingent jobs that we place, but also in our RPO space, where we're hiring – doing the full-time hiring in our RPO space. We've seen those largest accounts reduce their orders starting really in the fourth quarter of 2015, and thank goodness, there is enough companies still shifting to RPO, it's driving new customer growth, but the existing customer growth especially in those large accounts has fallen off a bit.

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So it's kind of that part of the cycle where the large companies are tightening first. They've held back on their own hiring and they've held back on some of their temporaries. We haven't seen large layoffs yet, but we've definitely seen some cautionary tells or signs in the largest customers.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. And then just one more quick one. I know it's still early in October, but can you discuss what's happened so far in October? Thanks.

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

A

Yes. So month-to-date results through October is included in our guidance, excluding Amazon. That decline has picked up to about 7%, so a couple extra points. However, there are comp moving from – prior year comparison moving from September to October got three points worse. So that's not to be expected actually as we take a look at seasonal trends just stripping away the percentages that I've shared with you. We're actually performing a little bit better than we'd expected once we ended September. So it's still early on, that's just three weeks of data that gives you a little bit of color.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)

Q

All right. Appreciate the help. Thanks so much.

Operator: Your next question comes from Sara Gubins with Bank of America. Your line is open.

Sara Rebecca Gubins
Analyst, Bank of America Merrill Lynch

Q

Hi. Thank you. Good afternoon. Do you think that the trends that you are seeing excluding Amazon are really off-cycle related or are you seeing any strategic or structural or competitive changes in any of your end markets?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Yeah. I think it's definitely cycle-related. And as I just mentioned talking to Jeff that we've seen it mostly with our large accounts first, that maybe they're planning further in the future and they send a signal earlier than small accounts. But there has definitely been a slowing from over the last four quarters in large accounts from the fourth quarter through what we've just reported here in the third quarter. At the same time, smaller accounts are plugging away fairly good, and small to medium businesses are doing better than the large ones as far as using more contingent labor.

As far as are the end markets deteriorating, I think it's just too hard to tell right now. There is so much mixed data on what's going on and we serve so many projects that approximately half of our downturn is a project ended and our client didn't pick up a new project. Whether that is opening stores or closing stores in the retail front or some of the energy projects that come and go, we've seen projects end and the new next project just didn't start. Now, it's hard to bleed in and wonder or know for sure whether that's cycle driven, Sara, or whether that's just some other factors in their business.

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Sara Rebecca Gubins
Analyst, Bank of America Merrill Lynch

Q

Okay. And could you remind us, of your business how much is focused – from a revenue perspective, how much is large company versus smaller?

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

A

Yeah. I'll give that information to you here. So, if we take our business and split it up between large and small, it's about half-and-half, half large, half small customers. Be – the mix changes a little bit in our branch business be more towards small size customers. But I'll just remind everybody here, for somebody to make it into the large customer account for us, it just needs to be someone with a geographic footprint that can be serviced nationally. We have quite a few customers here in the $500,000 to $1 million range that we would actually put in the large customer account, that maybe some others that you might follow in the industry, they would definitely consider that to be small to medium-sized business. But that's the split, about 50-50.

Sara Rebecca Gubins
Analyst, Bank of America Merrill Lynch

Q

Great. Okay. Thanks very much.

Operator: Your next question comes from Kevin McVeigh with Deutsche Bank. Your line is open.

Kevin McVeigh
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks. Hey, just – I don't know if this is possible to do, but the guide looks like it's about a $100 million miss relative to where the Street was. Derrek, if I heard it right, it seems like the run-off in Amazon is about $100 million relative to what you guys had kind of initially – the initial revision in terms of I thought it was going to be around $250 million, now you're coming in at $166 million. So – I mean, is this purely Amazon and is some of this that retail effect you've been talking about on the remodel side as opposed to the cycle? Just trying to understand that a little bit. And I guess my other question, at a high level, why wouldn't you guys preannounce?

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

A

Okay, so few questions in there. I'm going to take it in reverse order and then ask you a clarifying question here, Kevin.

Kevin McVeigh
Analyst, Deutsche Bank Securities, Inc.

Q

Okay.

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

A

So on the preannouncement, we generally haven't done a preannouncement. We don't set a precedence for this in setting an announcement. There is some that go other ways on that, but this wasn't a dramatic miss, certainly beneath the low part of our guidance. But most importantly, when we announce our results, we want to be able to talk with you all about it and provide a lot of color and transparency around it. So that's just basically our process.

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Back to your question on the guide, could you repeat that? I wasn't quite certain if you are talking about our previous annual guidance or our Q4 guidance or Amazon?

Kevin McVeigh
Analyst, Deutsche Bank Securities, Inc.

Q

Yup. So the Q4 guide, if I picked it up right, it looks like the range is $670 million to $686 million. The Street was around $775 million and I thought – maybe I'm wrong – that you guys were kind of modeling about $275 million in annualized revenue from Amazon, and now it looks like that's coming in at about $166 million.

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

A

Okay.

Kevin McVeigh
Analyst, Deutsche Bank Securities, Inc.

Q

So – I mean, it's not one-to-one, but it looks like it's about a $100 million adjustment to Amazon, and that's kind of the miss. So is it primarily that and some of the retail coming in, or is it really kind of the cycle turn? And I guess we're just trying to figure that out. And then the Amazon, when did that come about, because it seems like there has been a lot of moving parts around that contract?

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

A

Okay. Thanks. I understand better now Kevin.

Kevin McVeigh
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah.

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

A

So let's talk about a couple pieces on Amazon. I'll go down that track, and I'm glad you asked and I'm going to provide even some more color here around Amazon, because I think it will be helpful, beyond what you've asked.

So in 2015 we did $355 million of revenue with Amazon. When we talked with you all at the end of our first quarter and released our results and gave you news that they were going to be downsizing the use of our services and our fulfillment centers, at that time we said our best estimate for the year is $205 million of revenue. Okay? So where it will shake out right now is about roughly $165 million. So that's a $40 million drop, and most all of that's occurring in the fourth quarter.

Part of that, call it maybe a third of that $40 million, is related to the delivery station business, which we got news on that during the mid-part of the quarter, and so that's come out of our forecast. And then the other two-thirds of that $40 million drop, let's call it $25 million, is related to the fulfillment centers, and that's just Amazon using less of our services for a variety of different reasons. So you've got about a $40 million adjustment for the annual amount that we gave you, and all of that's really occurring here in the fourth quarter.

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While we are on this topic, just to remind everybody, we gave a forecast next year, basically a run rate forecast, as is now of about $30 million of revenue and $2 million of EBITDA. In our earnings release materials that we sent out today, you'll see also we gave the revenue on a quarterly basis in there. So you can take this $165 million that I just mentioned and break it up by quarter. But I also want to provide you with the EBITDA by quarter, and I'm going to do that right now. I think it's helpful for you to have this and we want to make sure that we're as transparent as we can, because I know these kind of shifts can make it challenging in understanding where things are going.

So, I'll give this to you by quarter here in 2016. First quarter of 2016, EBITDA was roughly $5 million. Q2 of 2016 was roughly flat. Q3 of 2016 was a $1 million loss. And in Q4 of 2016 we're expecting about $2.5 million of EBITDA in the guidance that we gave you. As a point of comparison, Q4 of 2015 was about $11.5 million of EBITDA, so there was about $9 million of EBITDA overhang in Q4. I think it's also important to give you – well, I gave you what Q1 of 2016 was, that's $5 million. So really what we have here, you can do some of your own calculations here, but we've got a couple quarters here of overhang EBITDA-wise until we get into the second quarter of 2017. So, let me pause there, Kevin. I think I got most of the Amazon question you asked and then some. I hope that hit the mark.

Kevin McVeigh Q
Analyst, Deutsche Bank Securities, Inc.

No, that's very helpful. And then just my last one, I'll get back in. It looks like – is it fair to say the lower tax rate helped earnings EPS by about $0.16? Because I think I was modeling around 32%. It looks like you came in at 13%. So was there $0.16 of help on the tax rate?

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

Well, you are talking on raw EPS, not our adjusted number, right? Because our adjusted number that we shared with you just keeps it at a flat 32%.

Kevin McVeigh Q
Analyst, Deutsche Bank Securities, Inc.

Okay. So the $0.70 is adjusted, it's for the 32%.

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

Yeah, that's right. The $0.70 that we reported today has our tax rate at a flat 32%, doesn't have that benefit in there.

Kevin McVeigh Q
Analyst, Deutsche Bank Securities, Inc.

Got it. Thank you, Derrek. Thanks, Steve.

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

Yeah.

Operator: Your next question comes from Randy Reece with Avondale Partners. Your line is open.

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Randle Glenn Reece
Analyst, Avondale Partners LLC

Q

Afternoon.

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Hi, Randy.

Randle Glenn Reece
Analyst, Avondale Partners LLC

Q

I guess I am in the same boat as everybody else, wondering about how do you isolate the weak spots in the business. Are there any geographic differences in your business trends? Is there any way you can identify regions that are any significantly different than the company average in terms of the way they trended through the third quarter?

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

A

Yes. I hit it from mostly an industry vertical perspective and gave color there, Randy, because that was the best way to kind of highlight some of the unique points. If we took a look at it by geography – I mean, I went through this and did some evaluation around it. I mean, for the most part it was somewhat consistent the trends that we saw. I'll give some directional color here. The West Coast comparatively if we were talking what is now versus what it was Q1 and Q2, slightly weaker. The Midwest probably somewhat that way, although the trends are just quite choppy; same with the Northeast.

Southeast and Southwest have been, all things considered, pretty resilient. That gives you a little bit of color from that perspective. Our revenue miss that we had this quarter of roughly $25 million beneath the low-end – or that would be $25 million actually from about our midpoint, about $5 million of that was in SIMOS. That was just new customer timing coming on. That acquisition is doing really well. They're still growing at a high-single-digit compared to 2015, so still growing quite nice.

The other $20 million was really in our branch-based staffing business, not our on-premise business that came in as expected. And excluding Amazon, that business has been growing pretty nice. I mean, it's still been growing mid to high-single-digit really all year long.

I think one of the underlying trends that we're seeing really in the business, whether it's our branch-based staffing business, whether it's on-premise, whether it's RPO, same customer revenue has just been sluggish. So where we are experiencing growth is from competitive takeaways, particularly in the staffing side, on-premise, same with RPO, or in RPO because of new first-generation customers, meaning customers that haven't used RPO before. But I think the underlying factor across all parts of the business is things have just been on a same customer basis quite sluggish.

Randle Glenn Reece
Analyst, Avondale Partners LLC

Q

Right. The strategy to re-brand at this time, can you give me a sense of timing of how you're going to stage this out and what it might cost next year?

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Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Yeah. This is something that we've been working on for quite some time, actually even before the Seaton transaction. We had our specialized staffing businesses to bring this together mainly for that point that I mentioned earlier that customers were getting a bit frustrated that TrueBlue had two or three different brands calling on them and offering services and looking like a competitor or not being clear. We look at it from the lost opportunity, where almost every customer can use all of those services and when we approach it properly with the right service angle, we were right.

So we've tested this in multiple markets. We've brought it together in stages. Some of the very first stages were answering the question, can all of these services be sold together? And several years ago, we started putting our sales force on this task and it's moved from a test basis to a full rollout already, where our salespeople that are out in the marketplace can sell Labor Ready, CLP, and Spartan. That's not a difficult task.

The second question was to say, well, can we recruit these candidates from the same perspective, and that one was a bit tougher. We found out that the specialization within recruiting needed to be protected and taken care of a little more, even to the point where when we were going to go out as one brand, we were going to need to add more recruiters to be able to recruit these various skill sets and talent levels for clients. And even going back to a year ago, when you heard us talking about adding more recruiters, it was really in preparation for this rebrand, where we were going to be selling and operating as one.

The third question was, well, can we operate those three as one, and the answer to that one is obviously yes. It's just a little more difficult, because you got to change your systems out, and so we've slowly been working on that the last three years with a heavy push here in 2016 and we've taken some of our internal systems and just made tweaks to them. And so what you see in our capital expense numbers is really what it's been taking. We've really hit our peak of bringing these together. It doesn't get more expensive from here. We've been buying new signage and stuff for the branches, so you've really seen the peak of what it takes to bring this together.

The leadership teams have been operating for almost two years as one, where the same leader at the regional and market level have taken on these multi-brands and been running them anyway. So the largest impact here this quarter really has to do with moving the system and getting everybody using this new payroll and billing system that can bill and do the payroll and compliance for all three brands. And that's been done, tested and rolled out. There is about a six-month rollout, though, to get every employee on that new system and get every customer being billed on that new system and getting every temporary associate paid on that system.

So there will be about a six-month tail of that happening, but the expense doesn't ramp up from here. As you can tell, it's been quite a process over the several years of getting this to come to be. Where it's out and functioning well, we're seeing great results. We're seeing the opportunity to place more skilled employees, where we were only selling general labor and vice versa, where we have great skilled clients, we're able to sell more general labor. So the early signs which have really been tested and played out the last three years are coming true. It's just taken that leap that we took this quarter, actually just a couple weeks ago, to flip the name legally and start putting the signs up and really be in the marketplace as PeopleReady and to have the websites functioning well, and that's really the big push this quarter on where we stand at this point in time.

Following up right behind this quickly is the strategy to put this entire group of PeopleReady on a mobile app. And you've heard me talk about that the last three years also. The swing of the temporary associates having more smartphones in their pocket. We had invested heavily in Work Alert which is an SMS-based, texting-based solution. That's been working very well the last four years. What we noticed quickly after we invested in our

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system is more and more smartphones were becoming apparent for our workers and we knew there would be a day that there would be more smartphones in their pockets than SMS phones and texting capabilities.

So we've been prepping for that day and we are a long ways down the road. Actually 80 of our branches have an app up and running, where the workers can choose their jobs from an app, and soon to be that customers can order on this app. And we're making great progress there and know that by the first half of 2017 we will have the entire PeopleReady organization up on this app and in a new age. That's going to open up a new type of worker for us.

It's going to open up more availability of those that are willing to look on their phone for a worker, but not necessarily – or excuse me – a worker looking for work, a job seeker looking for work on their phone, but wasn't willing to come into a branch looking for work, and we've seen those numbers and actually the diversity compared to our current worker base change rapidly. The gender being highly male in our current base and 50-50 that women are looking for this opportunity to seek a job by using an app rather than coming to the branch, and the age demographic changes quickly also.

So we're excited about that. Now that had to come together. You asked the question about PeopleReady and how long we've been working on that, and it has been three years or four years in the making. And now we find the day we could do this and then we have to follow that up with a quick app, so that brand gets all the power that we can get out of it.

Operator: [Operator Instructions] Your next question comes from Mark Marcon with R.W. Baird. Your line is open.

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

Q

Hi, Steve. Hi, Derrek.

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Hey, Mark.

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

Q

First, just a follow-up on that last one. So would you expect by Q3 that everything will be up and running in terms of the new brands? And what are you anticipating with regards to some of the legacy Labor Ready type workers being distinct from the CLP type? How exactly do you do that?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Yes. So, you said Q3. Did you mean Q4 or did you mean Q3 of 2017?

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

Q

Q3 of 2017.

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Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Okay, yes. Yes, we will be completely rolled out by Q3 of 2017, for sure, with this branding. It's going quickly. Everybody has some of the branding up and running, and there are just certain pockets that we're not recruiting skilled workers in. And there are certain pockets we're not doing light industrial manufacturing recruiting. We're just doing general labor. So this is really more of an opportunity to expand our services into those pockets, and so the rollout takes that long to get recruiters up and running in all markets.

The question of how do we segregate or keep the general labor separate from the skilled, and it really comes from our recruiting base. We're going to keep branches open, and that's really more dependent on how the mobile app works and whether we have enough workers coming to us through the mobile app, not based on branding. So the fact that these offices are open and the old Labor Ready office will now be a recruiting center for general laborers under the PeopleReady name and we'll keep as many of those recruiting centers open as we need to to recruit that general laborer until we know we're getting enough out of the mobile app.

As far as skilled workers, they are really recruited through a full-time recruiter, someone that builds a relationship with them and stays in contact with them and communicates when the job openings come to them and not – the skilled worker is not one that comes to the branch often. They used to, to pick up a paycheck or a timecard, but we've taken care of that with other forms of technology. So the skilled worker is already being managed remotely, and so they're really not being blended in with the general laborer right now. So it's really the old Labor Ready offices remaining open as recruiting centers for PeopleReady.

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

Q

Okay. Great. And then, you said you would be done by the third quarter. Could it actually be done by the second quarter of 2017?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Yes, and really what we're talking about done there is when they're using the combined system.

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

Q

Right.

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

That's what we're checking the box on the account.

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

Q

And every branch being branded appropriately?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

A

Yes. So yes, it could definitely be done by the end of June.

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

Okay, great. And then just going to Amazon, the underlying reason why they decided to go a different way relative to what they'd previously indicated was what – like how did they describe it? What was different in terms of their new expectations relative to what they previously expected?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.
A

They haven't shared a lot with us. What we do know and what we've seen from being in meetings with them, it's part of a broader strategy to in-source many functions that they had previously outsourced, especially in regard to shipping and delivery, that they would have more control over that and not be subject to providers, possibly to pick up some profit margin, not a lot there as we've disclosed. But the main thing I think is control and knowing that they're controlling their own processes more. So in-sourcing previous things, all the way to where they stand with UPS and FedEx, and wanting to control delivery right to the customer. So it's just part of a broader strategy that they've been implementing and tested a few things here and there, but went fairly quickly at the temporary labor aspect.

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

Do you sense that Integrity is being similarly impacted?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.
A

Yes.

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

Okay. And then how does this influence what you're – how you're thinking just about in terms of future sales efforts? For a number of quarters we've heard small and medium-sized companies doing well. National is a little bit tougher. Does that shift like how you're thinking about where to focus?

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.
A

Well, just as when we came out of the big recession, we noticed large accounts were growing and we had a fairly big ramp up that we had to do. We weren't established well with a big sales force and national account team that could handle the level of demand that we saw large customers dealing with. We really started getting on our feet with the Seaton acquisition, because they handle large accounts so well on that on-premise business. We often said during that ramp-up of large accounts in 2011 and 2012, though, we had not walked away from our ability to service small and medium businesses in the local market. We kept our branches open. We kept teams there. Although sales per employee had decreased and sales per branch had decreased, we stuck with that strategy.

So similar today, we're not losing customer count. What we're losing is purchasing dollars of each account. So the revenue per account is dropping, but the number of accounts aren't dropping. So it is a bit of a challenge, because we want to stay true to that strategy that we can take care of large accounts, and so we're going to stick with that strategy. We're not walking away. Where you invest, and it's a little faster to ramp up or easier to ramp up and down the local market of hiring salespeople and hiring recruiters on [ph] each as (54:49) it's not as easy

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on the large accounts, because there is less people handling those accounts. So bottom line, it's staying focused on both, Mark.

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

Q

Okay, great. And then obviously, everybody is going to be trying to come up with numbers for next year. As we think about this – it sounds like the expense – the expenses aren't going to ramp up materially because of the rebranding. How should we think about what the run rate gross margin percentage would be? Obviously, it's going to be impacted on a seasonal perspective. But as we think about losing the Amazon revenue and some other puts and takes, how should we think about that?

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

A

Yes, well, we haven't given any guidance for 2017. That's a tough one. Well, let's go this way. I think a good way to think about this is – that's why I wanted to give you the Amazon numbers, is to give you the revenue and the EBITDA and understand this EBITDA overhang. So with the revenue and EBITDA numbers from Amazon, I think you should be able to kind of work where you need to go, at least on an EBITDA basis, Mark.

I get that there is a lot of noise here in the gross margin line. But what I recommend you doing as you're taking a look at 2017 is remember what our comp drops to in Q1. So organic growth, excluding Amazon, our comp in Q4 of 2015 was 11% growth, which we're up against this Q4. And then in Q1 of 2017, it's up against a growth rate of 4%. So you can kind of do your own extrapolation of where the business from a revenue perspective would go ex-Amazon with that and project the revenue ex-Amazon. I think you could back into your EBITDA forecast with a little bit of math that I gave you today.

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

Q

All right. Thank you.

Operator: Your next question comes from John Healy with Northcoast Research. Your line is open.

John Healy
Analyst, Northcoast Research Partners LLC

Q

Thank you. Derrek, I wanted to ask a little bit more – I hate doing this – about the Amazon relationship. When you talk about the $2 million run rate of EBITDA going forward, does that assume any sort of revenue, what you say, revenue – a cost absorption by finding additional customers or additional big customers? A number of years ago when you guys had the Boeing kind of transition, you kept a lot of the infrastructure in place and redeployed it. Does that $2 million assume some redeployment or is that kind of an apples-to-apples number?

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

A

John, could you clarify what $2 million are you talking about right now?

John Healy
Analyst, Northcoast Research Partners LLC

Q

I believe in the slides you guys had a slide that talked about $2 million in EBITDA contribution kind of run rate?

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

Oh, yeah, yeah.

John Healy
Analyst, Northcoast Research Partners LLC Q

I was assuming that meant $2 million of EBITDA contribution on a 2017 basis versus the $30 million in revenue you are talking about there?

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

Yeah. So what we're basically saying is, if you take the revenue that we would have ongoing with Amazon right now and just kind of clear the deck, that's $30 million of revenue and $2 million of EBITDA. So put another way, if nothing changes in our relationship with Amazon, that's basically what we would be expecting for 2017.

John Healy
Analyst, Northcoast Research Partners LLC Q

Okay. Okay, that's fair. And then I wanted to ask the down 5% to down 8% organic growth that you guys are talking about, what would that look like on just a pure placement basis? Would that be worse than that or are there some things with mix that are causing the revenue numbers to maybe look different than the placement numbers?

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

Well, I don't have it broken out by placement, but the main thing that would be different between placements and the revenue number would be bill rate inflation. So probably a better way to think about it is maybe not placement, but hours. So we've been having bill rate inflation of about 4%. So whether you want to use placement or hours, that would be a factor you'd want to put into place in making your answer – really to answer your question.

John Healy
Analyst, Northcoast Research Partners LLC Q

Okay. And then just last question. With the $2 million service relationship you guys have on the RPO business, when does that hit next year? Is that in the first half or the second half?

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

Say that one more time.

John Healy
Analyst, Northcoast Research Partners LLC Q

I think you guys had a $2 million benefit in 2016 from the shared service relationship with Hewitt. When does that fall-off? Is that in the first half of next year or second half of next year?

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

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Yeah, it's pretty evenly spread. So what John is referring to is in our slides we've said how much the RPO revenue will be this year and the EBITDA. EBITDA of $17 million to $18 million. But there is $2 million of windfall benefit in that from just some favorable pricing, from a transition services agreement that our costs of doing some of those services will be higher. So that $2 million would be roughly evenly split by quarter across 2017.

John Healy
Analyst, Northcoast Research Partners LLC **Q**

Okay. Thank you, guys.

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

And I'm going to provide one other piece of information here that Mark asked on gross margin, about what our blended gross margin would be going forward. Probably the main piece of data to know here is what the gross margin for Amazon has been. And it's been roughly 15%. So we've given you our 2016 estimate for the Amazon revenue this year that will be in our results roughly $160 million, $165 million of revenue, and that's coming at a gross margin of about 15%. So I think you can use that to do some back out math to get to a new run rate.

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

Steven C. Cooper
Chief Executive Officer & Director, TrueBlue, Inc.

Thank you. We appreciate you being with us today and asking these questions and showing the interest. We will update you towards the end of the fourth quarter on our results. So thank you.

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

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