TrueBlue, Inc.

Fourth Quarter 2016 Earnings Conference Call

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CORPORATE PARTICIPANTS

Derrek Gafford, *Executive Vice President and Chief Financial Officer*

Steven Cooper, *Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

Randle Reece, *Avondale Partners LLC*

PRESENTATION

Operator:

Greeting and welcome to the TrueBlue Fourth Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. An interactive question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I'd like to turn the conference over to your host, Mr. Derrek Gafford, CFO of TrueBlue. Thank you. You may begin.

Derrek Gafford:

Good afternoon, everyone, and welcome. I'm here with our CEO, Steve Cooper.

Before we begin, I want to remind everyone that today's earnings call and slide presentation will contain several forward-looking statements, all of which are subject to risks and uncertainties and we assume no obligation to update or revise any forward-looking statements. These risks and uncertainties, some of which are described in today's press release and in our SEC filings, could cause actual results to differ materially from those in our forward-looking statements.

In addition, we use several non-GAAP measures when presenting our financial results. Please refer to the non-GAAP reconciliations on our website at www.trueblue.com under the Investor Relations section. Also, any comparisons made to other periods today are based on a comparison to the same period in the prior year unless otherwise stated.

As we discussed in October, our Fiscal 2016 fourth quarter includes a 14-week, and we moved the quarter ending date forward two days from Friday to Sunday, January 1st, to better align with the workweek of our customers. To facilitate comparison with prior periods and with the outlook we previously provided on a 13-week comparable basis, we'll be referencing both GAAP and comparable 13- and 52-week results.

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We will use the term GAAP for generally accepted accounting principles when referring to the 14-week or 53-week results ending January 1st, and the term comparable when referring to the 13-week and 52-week results.

Due to the previously announced reduction in the use of our services by our largest customer, Amazon, we will also be providing comparable results excluding this customer. We believe both sets of comparable results are complementary to our GAAP results and helpful in understanding the underlying trends in our business.

The revenue for the nine additional billing days was $34 million. However, since this is one of our lowest revenue weeks of the year, the gross profit dollars produced during this period are more than offset by operating expenses, resulting in an operating loss of approximately $1 million for the nine-day period. Any reference made during this call to a comparable 13- or 52-week set of results, exclude the nine additional billing days.

We made several changes in our reporting this quarter to enhance the transparency for investors. As we announced in October, we transitioned to three go-to-market brands during the fourth quarter of 2016. As a result, we are now reporting our results in three segments versus our prior approach of two segments.

Our previous Staffing Services segment is now divided into two segments; PeopleReady, our branch-based staffing business comprised of the former Labor Ready, Spartan Staffing, and CLP brands; and PeopleManagement comprised of the current Staff Management, PlaneTechs, Centerline and SIMOS brands, which predominantly serve customers from a location base at the customers' worksite.

Results of our previous Managed Services segment, which was comprised of our recruitment process outsourcing and Managed Service provider businesses, are now reported in our PeopleScout segment. We have also reduced the unallocated portion of our operating expenses, resulting in additional operating expense for each of the segments.

The annual run rate of unallocated operating expense was about $35 million and is now about $25 million. This action coincides with changes made to our internal management reporting to increase the accountability and transparency of our operating expenses.

Before I hand it over to Steve, I want to make you aware that we are no longer excluding processing fee expenses associated with the Work Opportunity Tax Credit from adjusted net income. Since these expenses are necessary to produce a lower effective income tax rate, we believe it's more reasonable to include these expenses in adjusted net income. However, these fees will continue to be excluded from Adjusted EBITDA.

Lastly, we have lowered the expected ongoing effective tax rate used in our adjusted net income calculation to 28% versus our previous rate of 32%. The new rate is a closer approximation to our results over the last four years and of our future expectation due to a higher yield on Work Opportunity Tax Credits.

Please note that we have recast all non-GAAP and segment information for all prior quarters and years back to 2014 on our website to ensure you have comparable results.

Okay. I'll now turn the call over to Steve.

Steven Cooper:

Thank you, Derrek, and good afternoon, everyone. Our earlier expectation was that revenue trends would worsen during the fourth quarter, given the strong prior year performance in Q4. However, due to strong momentum across all business segments and PeopleReady, in particular, we exceeded the outlook we provided in October.

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We're also pleased to report that comparable monthly organic revenue trends, excluding the loss of revenue from Amazon, showed consistent improvement. The improvement was largely driven by PeopleReady, our branch-based industrial staffing business and was widespread across most all geographies and across all business sizes, including our large national customers.

Our comparable 13-week revenue, excluding results from Amazon, grew by 5% compared to the prior year. We're also pleased to have maintained strong Adjusted EBITDA margins, despite the decline in total revenue. Our Adjusted EBITDA margin on a comparable basis was up 5.8%—it was at 5.8%, up 10 basis points over the same period last year.

We continue to emphasize disciplined pricing to optimize our bill and pay rate spreads, and we continue to focus on containing costs across all business units, along with driving synergies in our acquired businesses in order to keep the momentum of improving our EBITDA margins, which remains very important to us.

Our acquisitions are performing better than our original expectations. We acquired SIMOS at the end of 2015 and Aon Hewitt's RPO service line at the beginning of 2016. We're pleased—we've been pleased that these acquisitions have exceeded expectations from a profitability, customer retention, and employee retention perspective.

Commencing with the fourth quarter, we are now reporting on our business as three distinct segments: Specialized staffing, which is operating as PeopleReady; Workforce Management, which is operating through four brands within our PeopleManagement segment; and recruitment process outsourcing, which is operating as PeopleScout. This approach should also provide better insight for our investors.

Simplifying our service options and clarifying our branding structure as, we did with PeopleReady, ensures that our various segments work together more effectively as we provide businesses with the right people for both contingent work or for permanent positions, or better yet, a combination of both in a total workforce solution.

On a comparable 13-week basis, our revenue of $701 million during the fourth quarter exceeded the high-end of our outlook we provided in October, and represents an increase of 5%, excluding Amazon, our largest customer that has had significant declines in the past three quarters with the change in scope of service using their contingent labor.

Our comparable Adjusted EBITDA of $41 million was towards the high-end of our outlook range, and excluding Amazon, represents an increase of 14%. Derrek will provide more detail around the fourth quarter results here in a moment. We're as excited as ever about the prospects of our two staffing segments; PeopleReady and PeopleManagement.

Our new specialized staffing brand PeopleReady combines Labor Ready, CLP resources, and Spartan staffing into one brand that greatly improves the customer experience, while bringing the full range of our services to more markets.

Our new PeopleReady brand began its rollout across North America last fall, and we are unifying our branch-based businesses on a common set of information systems here in the first half of 2017. This move simplifies our suite of services in the eyes of the customer, bringing them more solutions and increasing our agility in each of the marketplaces where we operate.

One of the most exciting developments in our staffing business has been the introduction of JobStack, our mobile app for placing orders and dispatching workers in the PeopleReady business. As we've pointed out, more and more jobseekers are using smartphones, and to capitalize on this trend, years ago, we invested in WorkAlert, an SMS texting-based solution.

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Now, many of our PeopleReady branches are using the JobStack app, which allows workers to choose their jobs from an electronic stack of options through the app, and will soon allow our customers to place their orders using the app. We plan to have the entire PeopleReady organization up and running with JobStack this year to give us access to more workers of more demographics, including those who are unwilling or unable to come into a branch seeking work.

Customers will appreciate having more workers available, and our associates will appreciate being able to view all the available jobs stacked and tailored to their skills and qualifications to allow for easy swiping and sorting positions that they are interested in accepting. Our customers appreciate that they can place an order 24/7 on the app and the worker can immediately accept a position without needing to speak with our branch operations team. And through the app, customers can now immediately see when a worker accepts their job and can feel comfortable the shift will be covered by a PeopleReady worker.

Turning to PeopleManagement. The demand for industrial staffing continues to expand, as customers are relying on us more and more to manage a larger portion of their workforce needs. Our ability to increase productivity in our customers operations is a perfect fit with a growing world of digital commerce, which serving that sector is a strategic priority for us. We can provide the talent needed to ramp-up production, recruit and manage workforces of hundreds or even thousands of employees per site, and supply the drivers and logistics specialists needed to distribute goods.

In addition, our SIMOS solutions can help these locations save more than 15% in labor costs using a per-piece pricing model rather than an hourly pricing model. Digital commerce is emerging as a secular positive for us, as it tends to be more labor intensive for the warehouses, as the selection process is based on the order from a customer rather than orders being shipped to a retail store.

These digital commerce fulfillment centers need employees to pick and pack and handle what's known as reverse logistics, as return items now come directly back to the warehouse instead of a retail store. Put simply, while the traditional distribution warehouse focused on the movement of goods on a pallet using a forklift, in a digital commerce fulfillment center it's about thousands of individual items, and this demands a larger workforce that can ramp-up and down quickly based on the order flow from the online consumers.

Online sales are expected to continue to expand as a percentage of the overall retail market for the foreseeable future according to retail analysts. We are excited to be prepared to participate in this growth.

Lastly, we are also excited about PeopleScout, our RPO brand. We see growing demand for RPO services on a global scale, with companies increasingly turning to providers to efficiently scale their full-time recruiting functions. While we have a market-leading position in the US, which is the largest most developed market for RPO, we also see growth opportunities as the European and Asia markets rapidly develop and as companies serving multiple continents increasingly want a provider that can handle their global needs.

Companies worldwide are increasingly choosing to partner with a provider for their recruiting processes. They're interested in reducing costs, becoming more scalable and flexible and gaining better insight into best practices and technology. We view the adoption of RPO, both domestically and globally, as another secular force from which TrueBlue benefits.

We're beginning to see many large companies approach us to work directly with them in bringing together the right workforce at the right time in the right place. That sounds simple, yet with a shrinking pool of available workers, it's more important than ever that customers build a united front in their employment brand, and the best way to do that is to unite the effort of attracting, acquiring, and retaining both contingent and permanent employees and ensuring the proper balance is in place. TrueBlue Workforce Solutions is the key to properly manage in that challenge.

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I'll turn over the call to Derrek for further analysis of our results, afterwards which we will open up the call for your questions. Derrek?

Derrek Gafford:

Thank you, Steve. I'll start off by covering the results on a GAAP 14-week basis and follow-up with a summary of our key results on a comparable 13-week basis, followed by a supporting discussion of our operating trends. I'll follow-up with a discussion on our three segments and finish off with an update on our liquidity position before I share our outlook for the first quarter.

On a GAAP basis, revenue for the fiscal fourth quarter declined by 9% and net income was $18 million or $0.43 a share. Our results for the quarter boiled down to this. We posted stronger than expected bottom line results, driven by higher than expected revenue.

On a comparable 13-week basis, Adjusted EBITDA and net income per share of $41 million and $0.58, respectively, were at the high-end of the comparable 13-week outlook provided in October. Comparable 13-week revenue was $701 million, which exceeded the high-end of our comparable outlook of $686 million provided in October.

The better than expected revenue performance was the result of two factors. One, improving comparable organic revenue trends, excluding Amazon, which were as follows: October was down 6%, November was down 4%, and December was flat. Additional holiday-related business provided about 2 percentage points of benefit to December. And second, we expected to transition the former Spartan and CLP branches to a new operating system during the fourth quarter, which we elected to delay until after the holiday season. Our Q4 revenue outlook included about $8 million of headwind for this transition, or about 1 point of revenue headwind.

I also want to provide some color on the results from Amazon. On a comparable basis in 2016, Amazon contributed about $170 million of revenue and $5 million of Adjusted EBITDA, compared to 2015 revenue of $350 million and Adjusted EBITDA of $24 million. On a comparable basis, Q4 2016 revenue was about $30 million and Adjusted EBITDA was $1 million, compared to Q4 2015 revenue of $175 million and Adjusted EBITDA of $11 million.

Looking forward, the annual run rate of the business we expect to retain in 2017 is about $30 million of revenue and $2 million of EBITDA. Additional revenue and EBITDA details related to Amazon can be obtained in our Q3 earnings release deck and conference call transcript, both available on our website.

The annual run rate of Amazon revenue we expect to retain represents 1% of total Company revenue. Our next three largest customers each represent 2% and none of our other customers represent more than 1%. Taking a broad look at our revenue results, we saw improving or consistent trends across most geographies and industry verticals.

Moving on to gross margin. Gross margin was up 180 basis points, with a 110 basis points from the staffing business, largely driven by the drop in revenue with Amazon, which carries a lower gross margin than our blended average. Pricing adjustments and an improvement in recruiter utilization in the RPO business drove 40 basis points of increase and a higher gross margin within the acquired businesses contributed another 30 basis points.

Turning to our operating expense, we remained focused on scaling our costs in response to current business conditions. Operating expense was up $4 million on a GAAP basis, which includes $7 million of expense related to the extra nine days in the quarter; $11 million of ongoing operating expense from acquired businesses; and $2 million more of Adjusted EBITDA add backs net of a $16 million decline in the organic business.

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Excluding the nine extra days in the quarter and integration and other charges, operating expense on an organic comparable basis decreased by 10%. Our effective income tax rate was 21% for the quarter lower than our previous expected rate of 32%, due to a higher yield on prior year Work Opportunity Tax Credits.

Taking a look at our results by operating segment, PeopleReady comparable revenue declined by 6%. Comparable Adjusted EBITDA dropped by 21%, a larger decrease in the revenue decline due to the deleveraging effect associated with fixed costs in the branch network.

PeopleManagement comparable revenue declined by 29%. Comparable revenue, excluding Amazon was up 23%, largely from the SIMOS acquisition, which was acquired at the end of November 2015. Comparable Adjusted EBITDA dropped by 38%, but grew by 42%, excluding Amazon.

PeopleScout comparable revenue grew over 60%, largely driven by the Aon Hewitt RPO acquisition completed at the beginning of the year. Comparable Adjusted EBITDA grew by $7 million, both from the acquisition as well as from pricing and operating expense adjustments in the legacy business.

Our balance sheet strengthened in 2016 from strong cash flow, which we used to reduce debt and interest expense. During fiscal 2016, the Company produced cash flow from operations of $262 million and reduced its debt to capital ratio from 31% the year before to 21%, resulting in Adjusted EBITDA as a multiple of total debt at 1.1 times.

For the first quarter of 2017, the outlook for total revenue is a decline of 11% to 13%. Excluding Amazon, the outlook is a decline of 2% to 5%. Included in this outlook is a revenue headwind of 1 percentage point associated with bringing the three former brands within the PeopleReady organization on to the same operating systems. These types of system conversions involve an investment of time to train field personnel and a learning curve for our branch personnel lessening the time available to optimize revenue opportunities.

The first quarter outlook on an earnings per share basis is a net loss per share of $0.01 to net income per share of $0.04. The outlook for adjusted net income per share is $0.09 to $0.14 based on a share count of 42.3 million, and the outlook for Adjusted EBITDA is $12 million to $15 million.

Keep in mind that the first quarter is our lowest level of profitability since it only makes up a little over 20% of the total revenue mix for the year.

The reduced amount of business with Amazon made for a challenging 2016. But the Adjusted EBITDA headwind is behind us after the first quarter of 2017, providing an opportunity to get back to revenue growth.

Total Adjusted EBITDA for Amazon in 2016 was $5 million, all of which was booked in Q1 2016. Our Q1 2017 outlook includes $10 million of revenue and $1 million of Adjusted EBITDA for this customer versus $70 million of revenue and $5 million of Adjusted EBITDA in Q1 2016.

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

Operator:

Thank you. At this time, we'll be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question is from Randy Reece from Avondale Partners. Please go ahead.

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Randy Reece:

Good afternoon.

Steve Cooper:

Hi, Randy.

Randle Reece:

I wanted to discuss and get a little better understanding of—you're going from—it looks like comparable revenue growth in the mid-single digits in the fourth quarter and then the guidance is for year-over-year decline in the first quarter. I'd like to get some components of the underlying trends representing that change.

Steve Cooper:

Yes. Thank you for that. The growth in the comparable revenue was really driven by the acquisitions of SIMOS and Aon. On an organic basis, our results in Q3 and Q4 were about negative 3% and that's about where we're heading into the first quarter also.

Randle Reece:

Okay. So that's a very similar trend. Do you sense any difference in how quickly the customers have restarted production—restarted operations in the beginning of the year compared with a year ago as you stacked(phon) through the holiday idleness?

Steve Cooper:

I understand that. Yes, that's about the same as a year ago. We're not seeing a lot of environmental differences similar—yes, it's very similar that the minimum wage increases always cause our PeopleReady group to hesitate a bit as they're pushing through larger minimum wage increases but that's similar to year ago also. And so I think, as we closed out January, things are feeling very similar to a year ago.

Randle Reece:

So, the number of markets with minimum wage increases is comparable year-over-year?

Derrek Gafford:

Hi, Randy. I'd say that the number of markets is comparable. It's more concentrated in California this year compared to what we have seen in the past. So we're starting off this year. California has a $0.50 pay increase for the state overall, but there is roughly just a little south, let's call it about 10 cities that have some pretty sizable increases from a $1 up to $2.

So most of the pressure as far as getting our mark-up pass-through will be in the State of California early on. As you know, the challenge for us isn't getting the cost pass-through, or necessarily the burden—the payroll tax burdens on the costs. Our customers understand that they have that in their own businesses. It's to keep our margin whole, at least in the PeopleReady business, there's a mark-up of about 40% put on top of that and that's the challenge that we have in pushing these through.

However, I will say that we are off to a good start here in January. As we look back at where we were last year in that PeopleReady group, we ended the first quarter with maybe about 50 basis points of gross

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margin compression, which we—we worked on, really worked out a way really well as we move through the year. As we take a look at our January results and how we're doing right now, we're at this point holding pretty flat with the prior year. So we're off a really good start here. That's also having—and is incorporated in our guidance here a little bit of pressure on the revenue side as well. There's a bit of a trade-off particularly in that early days of a minimum wage pass-through, and so most of the pressure of that as I talked about is in California.

Randle Reece:

My last question is when I look at the impact of Amazon on the comparisons, does it affect any other segment and the PeopleManagement segment?

Derrek Gafford:

No, it's all in the PeopleManagement segment.

Randy Reece:

Great. Thank you very much.

Operator:

Once again, as a reminder, if you would like to ask a question, it is star, one. If there are no further questions, I'd like to turn the floor back over to Mr. Cooper for any closing comments.

Steven Cooper:

Well, thank you. We appreciate you joining us today to hear the explanations of our operating results of Q4, and most importantly, the longer-term strategies that we're working on that we've talked about here today. We look forward to updating you as we get to the end of Q1. Thank you.

Operator:

This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.

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