

Barrett Business Services, Inc. First Quarter 2022 Earnings Call

Good afternoon, everyone and Thank you for participating in today's conference call to discuss BBSI's financial results for the first quarter ended March 31 2022. Joining us today are BBSI's President and CEO, Mr Gary Kramer and the company's CFO, Mr Anthony Harris. Following their remarks, we'll open the call for your questions.

Before we go further, please take note of the company's safe harbor statement within the meaning of the Private Securities Litigation Reform Act of 1995. The statement provides important cautions regarding forward looking statements. the company's remarks during today's conference call will include forward looking statements. These statements along with other information presented that does not reflect historical fact are subject to a number of risks and uncertainties.

Actual results may differ materially from those implied by these forward looking statements. Please refer to the company's recent earnings release and to the company's quarterly and annual reports filed with the Securities and Exchange Commission for more information about the risks and uncertainties that could cause actual results to differ from those expressed or implied by the forward looking statements.

I would like to remind everyone that this call will be available for replay through June 4th 2022 starting at 8:00 PM Eastern time tonight. A webcast replay will also be available via the link provided in today's press release, as well as available on the company's website at www.bbsi.com. Now, I would like to turn the call over to the President and Chief Executive Officer of BBSI, Mr Gary Kramer. Thank you sir, please go ahead.

Thank you, John. Good afternoon everyone, and thank you for joining the call. Our positive momentum continued into 2022 as we had a fantastic start to the year. Our financial and operational results exceeded most of our internal and external metrics. We exceeded our internal estimates for client retention, NET client adds, and worksite employee growth, all of which resulted in better than expected financial results.

Regarding our client and WSC stack, over the past 18 months, we have been executing a strategy to increase the top of the sales funnel. And I am pleased to say that our sales leads exceeded our expectations in Q1. This is the result of our three pronged strategy.

First, to mature and deepen relationships with our existing referral partners. Second, to utilize technology and digital campaigns to target and nurture new referral partners. And third, to utilize technology and digital campaigns to target potential clients directly. Our leads, prospects, and client ads in the quarter were greater than the previous quarter and our best quarter post-pandemic.

I mentioned during our last call that the one-one selling season was our best January for net new business in the past five years. The next trend that we previously discussed is that we've been able to sell and support larger clients with our upgraded technology stack and national PEO licenses. This continues to progress favorably, and the average size of the clients that we're adding are larger than the average size of the clients that are running off.

Regarding client runoff, our retention continues to be stronger than pre-pandemic levels. I like to attribute that work to the work we're doing in the field to support our clients and the value our teams bring in this ever changing and complex economic environment. The results of all these efforts were what I refer to as our controllable growth, is that we added 3,500 worksite employees year over year from net new clients. This was ahead of our plan and our best quarter in over five years.

We build as a percentage of payroll and we grow as our clients grow by adding worksite employees with wage inflation and as hours worked increases. Our client base is resilient and exceeded our internal forecast for worksite employee growth in the quarter. Regarding our financial results. During the quarter, our gross Billings increased 16% over the prior year quarter and exceeded our expectations.

For PEO business, our average worksite employees were up 9% over the prior year quarter and as the culmination of the controllable growth as well as our clients hiring. We exceeded our internal forecasts for our worksite employee stack. Our staffing business increased 18% over the prior year quarter, and we continue to experience favorable year over year growth trends.

We are seeing more applicants, we're placing more applicants, and companies are increasing wages to attract employees. It is still a thin recruiting market and we are unable to fill all orders, but our fill ratio is improving. We could have grown more, but we continue to have challenges filling orders with the tightness of the labor market.

We've made investments in staffing and recruiting and we're seeing positive results in recruiting for our PEO clients. Moving to the field operational updates. Over the past two years, we've evolved our branch and business unit model as we adapted to COVID but also to the shape of my vision as CEO.

Regarding our business unit model, we are able to revise the structure and migrate into a six person team from a four person team, which allows us to service more clients with less management employees and increases our return on management payroll. Regarding our branch network. Over the past two years, we have consolidated branches with the intention of continuing to grow revenue while servicing our clients.

And consolidations in these various branches allowed us to leverage mature teams and leadership to achieve better profitability. We never abandon a market, but rather, are servicing and selling into a market in a more cost efficient manner. We also evolve how we enter new markets with our asset light model, where we will hire and train a professional in a new market, assist them with our digital sales initiatives, and then have them sell into the market.

We will service the clients out of corporate with a virtual business unit and invest behind them in infrastructure as they build up their client base. All of these strategic evolutions, it starts to complicate our historical reporting regarding quantity of branches and business unit stratification. As such we are updating our reporting to better reflect how we think of the business.

We structure our operations in the context of how many local markets we can sell into and service locally. At the end of Q1, we operated in 13 states and 68 markets, which is consistent with Q4 of '21. Some markets will be more profitable than others due to their maturity. But with our evolution, every market is expected to be profitable.

Regarding macroeconomic updates. The growth in worksite employees for our install base during the first quarter was strong, and our April numbers were equally strong. Payroll data is a lagging indicator by a couple of weeks due to timing of pay cycles, but we don't see any indication in our data that would give us pause or concern about the future.

As the payroll and HR company for over 8,000 clients over various states and industries, there is nothing in the data that would reflect the slowdown at this time. However, we would be remiss if we didn't acknowledge that times are growing more challenging for business owners given tight labor markets, record inflation, supply chain challenges, and a rising interest rate environment.

As we look ahead to the balance of the year, our confidence in raising guidance starts with our higher than expected Q2 starting point for our install base of clients and WSC stack. Plus optimism of our revamped and disciplined sales and service teams executing on controllable growth and a slower increase in client hiring toward the back end of the year.

Anthony will provide more color to our full year outlook in his prepared remarks. As I think in the future, I've never been more optimistic about BBSI trajectory. We have consecutive quarters of great momentum, and I don't see it slowing. Our client retention is the best it's ever been, and we are seeing and closing on more prospects.

Our prospects continue to be larger because of our tech stack coupled with our nationwide offering, and we will continue to invest in technology and continue to invest in initiatives. Simply put, we are executing to our plan. Now I'm going to turn the call over to Anthony for his prepared remarks.

Thanks, Gary, and hello everyone. I am pleased to report that we had strong results for the quarter in all areas of our operations. PEO gross billings increased 16% over the prior year quarter to 1.68 million, while staffing revenues increased 18% over the prior year to 22.9 million.

As Gary noted, our increase in PEO growth billings was driven by stronger than expected growth from net new clients in the quarter, stronger than expected hiring within our client base, and higher average billings per WSC. Overall, WSC has increased 9% over Q1 '21, and average billing per WSC increased 6% driven primarily by higher wages.

PEO growth billings growth by region versus the prior year first quarter were as follows. Mountain states grew 38%, East Coast grew 25%, the Pacific Northwest grew 19%, Southern California grew 13%, and Northern California grew by 11%. As expected, we are now seeing Southern California return to growth levels more consistent with other regions as clients there have expanded hiring and increased wages. And this trend has continued through April.

In addition, every region is on or ahead of plan for controllable growth that is growth from clients added, less clients lost in the period. Our gross margin rate remains on target for the year and benefited in the quarter from favorable payroll tax rates, which included a combination of favorable statutory rates, and wage caps not increasing at the same pace as average wages. This benefit is primarily realized in Q1 as most employees reach their payroll tax wage gaps in the first quarter.

The workers' compensation market remains competitive, but we are seeing stabilization in pricing and competitor behavior. There have not been significant changes in market pricing in recent periods. Worker's compensation expense continues to trend positively with continued favorable claims frequency and favorable development on historical claims reserves.

This quarter included an actuarially determined reduction of prior year estimated liabilities of \$2.9 million compared to \$1.2 million in the year ago quarter. As a reminder, with our new fully insured workers compensation model, the company has significantly de-risked its workers compensation program for current year claims.

Looking at operating expenses, SGA in the quarter is on plan and we continue to invest thoughtfully in the business while navigating market increases and employer related expenses. We continue to expect earnings leverage to be on target for the year. Our investment portfolios are in \$1.6 million in the first quarter compared to \$1.8 million in the prior year.

With the increase in interest rates in the quarter, our fixed income portfolios moved to an unrealized loss position. But we intend to hold these securities, and our portfolio continues to be managed conservatively, with an average duration of 4.1 years, average quality of investment at AA, an address book yield of 1.8%.

The net of these overall strong results is that we generated positive net income in Q1 for the first time in over 10 years. As a reminder, BBSI typically shows a loss in Q1 due to the timing of when payroll taxes are incurred in the year. Turning to the balance sheet, we had 127 million of unrestricted cash investments at March 31 compared to 166 million at December 31. The decrease from year end is primarily due to the timing of payroll tax payments as well as stock repurchases and the paydown of our mortgage and certain leases in the quarter.

As a reminder, BBSI is now debt free. Looking holistically at the business, we remain committed to driving shareholder value through our strategy of generating consistent, profitable growth in earnings leverage, de-risking our workers compensation program, investing in growth initiatives, including IP, sales strategies, and expanding into new markets, and returning capital to shareholders through our dividend and stock buyback.

We announced last quarter that the board approved a new \$75 million stock repurchase plan and we commenced acquiring shares under that plan in March. Through May 3rd, we have purchased 241,000 shares that aggregate purchase price of \$18 million, or an average of \$74.80 per share.

Of that, 115,000 shares were acquired in Q1. The company also paid \$2.2 million in dividends in the quarter and reaffirmed its dividend for the following quarter. We're also on track for strong billings growth in earnings leverage in the year. And given the strong results for the quarter and more favorable expectations going forward, we are increasing our full year outlook.

We now expect gross Billings for the year to increase between 10% and 12%, up from 7% to 9% previously. We expect average WSC to increase between 4% and 6%, up from 3% to 4% previously. [INAUDIBLE] gross margin as of gross billings to remain between 3.0% and 3.1%, and we expect our effective annual tax to be between 25% and 27% up from 24 to 25%. I will now turn the call back to Gary for closing remarks.

Thanks, Anthony. We continue to always think of the client first and to advocate for the success of the business owner. I want to thank all of our professionals who work tirelessly to help our clients thrive. We've been working on the right things and I think we're in a great position.

Thank you sir. At this time, we'll be conducting a question and answer session. If you would like to ask a question, please press star 1 on your telephone keypad. A confirmation tone will indicate that your line is in the queue. You may press star 2 if you would like to remove your question from the queue. For participants using superior equipment, it may be necessary to pick up your handset before pressing any star keys. One moment please, we'll be full for any questions. Our first question comes from the line of Vincent Colicchio with Barrington Research. Please proceed with your question.

Yeah, nice quarter, gentlemen. I don't know if this one's for Gary or Anthony. Can you talk about the distribution of revenue and earnings in the final three quarters of '22?

Yeah, I can speak to that. So we're still expecting sequential growth each quarter. In terms of year over year growth, we noted that Q4-- that Q1 would be our largest expected year over year growth because of a softer compare last year. So we saw that obviously, we did even better than we expected with 16% billings growth.

Q2 and Q3, we think will be strong. Q4 will also be strong, but we noted that there'll be one less business day in Q4. So with that, there will be a little bit lower percentage year over year because of that missing business day. Profitability, similar trend to the past. Q3 typically score highest, Q2 and then Q4 will be impacted a little bit. Payroll tax is coming back in the latter part of that quarter.

OK, thanks for that. And Gary, given the economic risks that are out there and, you've got a very strong financial position, will you be a bit more cautious in terms of maybe on the acquisition side? And does pricing look-- does pricing improved at all on that side of things is an old question?

I would say pricing has improved for sellers not buyers still. Just in general, it is a competitive market out there on the acquisition space. We are still looking at acquisitions-- we are good stewards of capital continue to be thoughtful. We're not going to chase valuations and we're not going to chase undesirable structures. But we are active in looking in the market, we just haven't found one that fits our profile yet.

And how are you operating on the pricing side? Are you selectively increasing pricing given the-- I guess overall, I'd like to know how the pricing is trending and if there's any pushback from any clients giving wage pressures.

A couple of things. So as our clients grow, we make better-- we make the same margin but we make more margin dollars as our clients grow. So just by our clients growing, we make money on-- we make more margin dollars on WSC growth and wage inflation growth. I'll say pricing for workers' Comp, Anthony mentioned it in his prepared remarks, it is more rational now.

We do see some competition every once in a while where somebody is trying to buy an industry or buy a business, but it is more rational and people are, I'll say-- be more professionals with their pricing and the workers' Comp market. And we've seen-- specifically the WCIRB, which is the rating agency for California, has put through a proposed rate increase for 7.4%.

Ultimately, carriers are going to charge what they think the risk is worth. But just the idea that the state is now waking up to the realization that rates need to go up is a good sign. So in general, we tend to try to price in accounts to make sure that we're getting our return on management payroll dollars as well. And I would say that hasn't changed.

And now Anthony, what was the year over year same customer WSC growth in the quarter?

So we added, as Gary noted in his remarks, about 3,400 worksite employees from net new customers, and about 6,500 worksite employees from customer hiring year over year.

OK, thank you, I'll go back in the queue.

And our next question comes from Chris Moore with CJS securities, please proceed.

Hey, good afternoon guys, thank you for taking your questions. My phone broke up, Anthony, when you were talking about the cadence of profitability on a quarterly basis.

Yeah, no worries. It's a pretty typical cadence to our standard pattern, obviously. Q1, income is affected by payroll taxes, we had a great top line billings growth in Q1 partly because the compare last year was a little weaker. The rest of the year, we're expecting strong sequential growth. As Gary said, we're well positioned for the year in talking about the fundamentals. I did note, again, to remind you that Q4 has one less business day than last Q4, so the year over year [INAUDIBLE] did a little bit. Overall though, we're seeing strong momentum from here.

Got it. In terms of the Q1 profitability, I mean, you had a bigger than normal worker's compensation, so I think you would have had a loss of around \$0.25 without that. But is this timing of payroll taxes, is this a new trend for, say, Q1 next year or is it likely we're back to the normal loss in Q1 moving forward?

That's a great question, Chris. It's interesting with the pandemic, obviously, there was significant unemployment claims for a period of time. States have generally held back pushing those costs down to business owners. Rather they be there and not push those costs at all or they've entered into programs to phase in those increases over time. So we really have not seen increases.

And in fact have seen statutory rate decreases, which you would not typically expect that the funding levels of those unemployment trust accounts. So it's a little bit to be determined what happens next year or the year after. But in theory, unemployment tax rates will need to go up to replenish those funds.

Got it. And in terms of investment income, in this rising interest rate environment, can you talk about that again. It sounded like it was 1.6 million investment income in Q1 versus 1.8. Just in terms of your thoughts for the balance of the year, is that 1.6 going up or there's also some unrealised loss in there. So maybe just talk through that a little bit.

Yeah. It's generally fairly stable. It's a fixed income portfolio, so these are bonds and we tend to hold them. There's some variable rate holdings, so that will put some upward pressure, which is fantastic. That would be offset by our general guidance in the past that with our new fully insured program, our collateral requirements will continue to come down. So some of our investment balances will come down over time.

Sure.

We've talked about how rate increases might help offset that and I think that's more true now. So overall, I would expect fairly steady and definite returns.

Got it. Appreciate it, I'll jump back in line. Thanks guys.

As a reminder, if you would like to ask a question, please press star 1 on your telephone keypad. The confirmation tone will indicate that your line is in the queue. And our next question comes from Jeff Martin with Roth Capital Partners, please proceed.

Thanks, good afternoon guys. I wanted to dive into the asset light model a little bit more in detail. You mentioned eight clients were either added or contracted through February, if you could give us an update there and maybe just talk qualitatively as well about progress with initial four geographic locations that you started last year.

Yeah, hey Jeff. So for the four markets that we're in and using this asset light model, I can say that we're very pleased with the outcome so far. We spent a lot of time on training, we spent a lot of time on development, on immersion training, on role-playing, and we think we have a good formula for folks to be successful quicker and we're seeing that success quicker.

I would say the markets are performing at or better than what our expectations were. So the servicing as well is handling and doing the servicing virtually has really gone over well too in those markets. So they're able to sell, we're able to service. For certain markets, we're using our digital technologies to market to referral partners in the market to direct clients. I would say that we're-- I mean, I hit it with my closing, everything we're working on is working and we're hitting our plan numbers and we're pretty pleased with where we are for that regard.

Sounds like it's going reasonably well, reasonably ahead of expectation, that's great to hear. You also mentioned the pipeline was 50% higher in Q4. And that this day, I believe you mentioned it continues to strengthen. But I don't know if you want to add any detail to that.

Yeah. I mean, we're-- yeah, you're seeing the economy, over the last back half of the year, reopen and we saw good momentum into Q1. Q1 was our-- one was our best selling season and I'll say over five years. And we have a discipline now of how we handle our activities, what we do in those activities.

The one the one focus we've had is think of it as trying to make new friends or make new referral partners. Throughout this duration, I can just tell you that the leads that came in this quarter, 120 of those leads were from new referral partners for new relationships that we fostered. And most of those relationships, we were able to get them into the BBSI ecosystem through our digital strategy.

So we're seeing really good things and feel positive that these are now-- when we broke them out and talk about them before, it was because it was an initiative. Now it's part of the DNA and operationalized, and it's part of our foundation for how we do what we do.

OK, great. And then I was just curious if you could comment on the WSC-- average WSC growth guidance of 4% to 6% and I put that in context to the last three quarters where you've grown between 8% and 9% year over year. Is that just a degree of conservatism given some of the uncertainties there or are you expecting something to knock that growth rate down towards the back half of the year?

Yeah. I think maybe a little conservatism, but I think more broadly, it is looking at the trend and the year over year compare. The shape of that bill, I think as we look at our forecasts and including external forecasts and other metrics that we use in our modeling, we have tempered that growth in our model the latter part of the year, and we knew that we were going to have stronger growth, including on that metric at the beginning of the year. So it's a foundation of those vectors.

Yeah. I would say, Jeff, we had strong growth in WSC in quarter one. So we think of it as two things. One is, what do we control? And that's clients we add and clients we keep in our WSCs. And then the second is how our clients grow. And I can say that we beat on both metrics as far as our controllable WSC growth, and then our clients hiring.

And if you look at unemployment and where things are, you feel like hiring has to slow down with where the labor market is. And we baked that into our assumptions and plan for the year. But Q1, our client hiring exceeded our expectations and then we're just kind of looking at the back half of the year saying, can we get that WSC growth in our install base and this tight labor market?

Yeah. OK. That's helpful, thanks. And congrats on a good start to the year.

Thanks, Jeff.

And our next question is a follow up from Vincent Colicchio with Barrington Research. Please proceed with your question.

Yeah. Gary I'm curious, if the economy slows, say in the second half, we've got some macro headwinds out there obviously, is there more branch consolidation that you can do and what other actions may you take?

The Fed has 400 economists and it seems like we can't get a good prediction out of anybody. So from where we're sitting now, our data is strong, and I was trying to convey that in my prepared remarks, we don't see anything in our data that gives us any pause and concern for a slowdown now. But we do realize that there's headwinds out there for the various things.

This feels different, this feels more-- right now, you have record unemployment, your unemployment rate is the lowest it's been in probably our lifetime. And this doesn't feel like a, I'll say a historical recession, I don't know if there's going to be a compare for this when one happens.

If I look at the industries we're in, we're not in industries that I see slowing down as far as construction, transportation, logistics. The blue grays, I don't see that slowing down this year at all. And then as you look out into the following year, time will tell. But I feel like for where the economy is and the country is and where BBSI is placed in that diagram, I feel good for where we're at.

So we through-- the whole world went through the shock of the pandemic. And I think we weathered through that pretty well as a company. I mean, Q20, our revenue was flat and we still put up a 439 for EPS. We were able to manage through it and I feel like the teams in the field, the company in general, our financial positions, I feel like-- I feel like we can take whatever the world has to throw at us.

And one clarification, did I hear that the pipeline was up 50% from Q4, is that the right number?

Jeff mentioned that, I think our lead-- it was a stat he gave as a subset of the pipeline that our leads are up, yeah.

Yeah, it was a stat for Q4 not Q1, I think.

Your leads were up 50% from Q4 to Q1?

He was quoting-- that was from Q1 or Q4, I don't have that-- I don't have that number in front of me, Vince.

OK, thank you. That's it for me, thanks.

At this time, this concludes our question and answer session. And I would now like to turn the call back over to Mr Kramer for any closing remarks.

Thank you, everybody, for joining the call, thank you to everybody at BBSI who does what they do. We had a really good quarter, we have a really good momentum turning and we're positive about the outlook of the company. So thank you everybody.