Barrett Business Services, Inc. Fourth Quarter 2023 Earnings Call

Good afternoon, everyone and thank you for participating in today's conference call to discuss BBSI's financial results for the fourth quarter and full year ended December 31, 2023. Joining us today are BBSI's President and CEO, Mr. Gary Kramer; and the company's CFO, Mr. Anthony Harris. Following their remarks, we will 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 facts, 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 March 28, 2024, starting at 8:00 p.m. 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. Kramer. Sir, please go ahead.

Thank you, and good afternoon, everyone, and thank you for joining the call. We had another strong quarter, capping off an equally strong year, and I am pleased with our results. Before I speak about our financial performance, I would like to recap some of the key operational and strategic accomplishments for the year. We are successfully selling and servicing BBSI benefits in every one of our markets. Our existing clients are buying and so are new clients. On the new clients, we are seeing success in white collar verticals that we previously had a difficult time penetrating. Our strategic sales initiatives have been operationalized and are resulting in consistent and predictable acquisition of new clients and new referral partners. We continue to invest in our asset-light model and have successfully expanded into new geographies and are gaining momentum.

We continue to invest and perfect our other new products with BBSI U and BBSI recruiting. We continue to invest and bolster our tech stack with enhancements to myBBSI. And we also made further advancements on our Employer of Choice Initiative and earned the Great Place of Work designation for the third year in a row.

Our client retention continues to trend better than the pre-pandemic error. Every year, we conduct the survey of our clients to evaluate customer satisfaction and needs. This year, we modified our survey sum so that we could calculate a Net Promoter Score, which is an evaluation of how many of our clients would be willing to recommend and refer BBSI.

I am pleased to say that we scored a 64. To put this in perspective, a Net Promoter Score above 0 is considered good, and anything above 50 is exceptional. This gives us great confidence in the value our clients place on the services and solutions we provide. Our clients love what we do, and they are ready and willing to spread the word about BBSI. 2023 was a great year for BBSI, and I am proud of what our team accomplished.

Moving to our financial results for the quarter. We surpassed our gross billings estimate for the quarter by continuing to execute on our various strategies to increase the top of the sales funnel. In 2023, we added 6% more WSEs from new client adds versus the prior year. I am pleased to say that we once again exceeded our controllable growth expectations in the quarter for net new clients. We finished the year with more WSEs than we forecasted, which sets us up well for the start of 2024.

As discussed previously, we have been able to sell and support larger clients with our upgraded technology stack national PEO licenses, along with BBSI benefits. This continues to progress favorably, and the average size of the clients that we are adding are larger than the average size of the clients that are running off. Regarding our client runoff, our retention in the quarter continues to remain stronger than pre-pandemic levels. I'd like to attribute that to the work we do with our clients and the value our teams provide. The result of all these efforts or what I refer to as our controllable growth is that we added approximately 3,800 worksite employees year-over-year from net new clients.

To summarize for the year, we grew our worksite employees by 2.2%. Year-over-year, we sold and retained more business, which was partially offset by reductions in WSEs at our existing clients. We started to see client workforces stabilize in Q3, and that trend continued in Q4.

Moving to our staffing operations. Our staffing business declined by 22% over the prior year quarter and was in line with our forecast. We mentioned previously that we repriced the portfolio and jettison clients where we were not achieving an adequate return. We also shifted our strategy to recruit for our PEO clients and placed 83 applicants in the quarter. We are also experiencing macroeconomic factors, including supply and demand imbalances, which varies by geography. We expect our staffing revenue to stabilize in 2024.

Moving to the field operational updates. We are very pleased with our entrance into new markets with our asset-light model. We have 15 total new market development managers in various stages of their development. They are doing well in largely achieving their goals of adding and servicing new clients and new referral partners. Some of these will graduate to a traditional BBSI branch in 2024 as we are actively searching for real estate and recruiting locally to support the business. Our next class is in training and will begin selling in their markets in March. We anticipate that we will have 3 classes this year depending upon the talent in the marketplace.

Regarding our product updates, we continue to execute on the sales and service of BBSI benefits, our new health insurance offering. We had a successful year-end selling season, and I am pleased to report that through January, we have approximately 275 clients on our various plans with more than 6,800 total participants. Our value proposition resonates well, and we are having success with small and large clients in white- and blue-collar industries in every state we operate and with a diverse distribution channel. We are pleased with these results and this product will be accretive to earnings in 2024. We are in a great position and will now reap the benefit of leverage through scale.

For BBSI benefits, we have operational plans in 2024 to enhance our tech, refine our processes and add additional carriers to our offering. We think the additional carriers will be attractive and compelling in certain markets and may further accelerate our growth. We are estimating that we will double our participation by January of '25.

Next, I'd like to shift to my view of 2024. We have consistently achieved strong controllable growth by focusing on the needs of our clients and by adding new clients. These actions more than outweighed our clients' workforce reduction in 2023. We have more product to sell, more folks selling it and more referral partners recommending BBSI. We will have additional health insurers to offer and will have additional client-focused advancements in IT that are going to make our value proposition more compelling. If there is no dislocation in the economy that we expect to see greater gross billings growth in 2024 than in 2023.

Now I'm going to turn the call over to Anthony for his prepared remarks.

Thanks, Gary. Hello, everyone. I'm pleased to report we finished the year with strong results and strong momentum in our sales pipeline. Gross billings increased 4% to $7.7 billion in 2023 versus $7.4 million in the prior year, while diluted earnings per share increased 13% to $7.39, and compared to $6.54 in the prior year.

Looking at Q4, our gross billings increased 5% and to $2.05 billion versus $1.95 billion in Q4 of 2022. While diluted earnings per share increased 32% to $2.16, compared to $1.64 in the prior year quarter. PEO gross billings increased 6% in the quarter to $2 billion, while staffing revenues were $22 million in the quarter, representing a modest increase on a sequential basis but a decline year-over-year of 22%. Our PEO worksite employees grew by 2% in the quarter, which was the result of strong controllable growth from net new PEO clients. Offset in part by slower hiring within our existing customer base.

Looking at trends and client hiring more closely, we continue to see hiring stabilize in the quarter with most of the year-over-year WSE reductions occurring early in 2023. The pace of hiring remains broadly slower than historical trends. But we continue to see the largest impact concentrated in the construction sector and in our Northern California region. Average hours worked and overtime hours per employee have also remained stable in the quarter. And for the first time in over a year, total overtime hours worked were higher than the prior year quarter. Average billing per WSE increased 3% in the quarter, driven by higher average client wage rates, which remain resilient and which will continue to be a source of billings growth going forward.

Looking at PEO gross billings growth by region versus the prior year fourth quarter, the East Coast grew 16%, Mountain States grew 10%, Southern California grew 6%, the Pacific Northwest grew by 3% and Northern California was flat.

Turning to margin and profitability. Our workers' compensation program continues to perform well and benefit from favorable claim frequency trends and favorable claim development. This strong performance has once again resulted in favorable adjustments for prior year claims. In Q4 2023, we recognized favorable prior year liability and premium adjustments of $5.4 million compared to favorable adjustments of $600,000 in the fourth quarter of 2022.

As a reminder, our client workers' compensation exposure is now primarily covered by our fully insured program with no retained liability by BBSI. Our gross margin rate improved in the quarter due to the cost savings from lower workers' compensation expense and our ongoing focus on pricing discipline.

Our overall profitability has continued to benefit from operating cost management. For both Q4 and the full year 2023, SG&A expense increased by approximately 3%. As a result, SG&A for the year grew slower than our billings growth rate, and we expect this trend to continue in 2024 providing ongoing operating leverage.

Moving to investment income. Our investment portfolios earned $1.7 million in the fourth quarter. And our investment portfolio continues to be managed conservatively with an average duration of 3.1 years, average quality of investment at AA, and average book yield of 2.8%. Our balance sheet remains strong with $152 million of unrestricted cash investments at December 31 and no debt.

Our philosophy for capital allocation remains unchanged. We continue to prioritize our investments back into the company on strategic value-add initiatives. Over the last several years, these initiatives included expanding our IT capabilities with the launch and continued enhancement of myBBSI, the launch of new products, including our health benefits offering, our client learning management system and improved system integrations among others, and geographic expansion, which has been accelerated by our asset- light approach in new markets. We expect our level of investment in these areas to remain similar going forward as we continue to enhance our product and expand our reach. Beyond these investments, our next priority is to distribute capital to our shareholders.

Continuing under the Board's July 2023 repurchase program announced last year, BBSI repurchased $5 million of shares in the fourth quarter at an average price of $111 per share, with $59 million remaining available under the program at year-end. In total, in 2023, we repurchased over 5% of the company's shares outstanding through purchases of more than $34 million. We also paid over $8 million in dividends for the year, bringing total capital return to shareholders in 2023 to $42 million. Looking ahead to 2024, we expect to continue to generate excess available cash and to continue these capital allocation strategies.

Now turning to our outlook for 2024. We expect gross billings and average WSEs to strengthen from 2023, with 2024 gross billings expected to increase between 6% and 8% and average WSEs to increase between 4% and 5%. As a baseline, we expect client wage inflation to continue at a similar -- to 2023. But for 2024, we now also expect a return to positive net client hiring. While 2023 had net negative client hiring, most of the reductions occurred early in the year, with trends improving as the year progressed. While only modestly factored into our outlook, we are also starting to see signs of residential construction spending improving, benefiting our construction sector clients, which were a primary driver of declines in 2023.

Beyond our client hiring, we are optimistic about the momentum we see in our sales pipeline. And 2023 has shown that even in the year with negative client hiring, we were able to grow our total WSE stack by adding new customers more consistently. This improvement in our ability to sell and service through economic fluctuations will bring even more stability to our long-term growth. For 2024, we expect gross margin as a percent of gross billings to be between 2.95% and 3.15%, in line with our 2023 rates with pricing adjustments being matched to ongoing cost savings. Finally, we expect our effective annual tax rate to be between 26% and 27%.

I will now turn the call back to the operator for questions.

Our first question is from the line of Chris Moore with CJS Securities.

It's actually Elijah Gould for Chris this evening. So Gary, I guess just starting with health care first. Some of your health care competitors obviously take underwriting risk on the health care, but you don't. Can you talk a little bit about the puts and takes? And clearly, there's less risk for you all, but what are you giving up as a result?

Yes. Good question. I mean we've -- over the years, we've evolved our model on the workers' comp side so that we no longer take the workers' comp risk, we lay it all, primarily all of it off to the insurance and reinsurance market. So when we brought on the health care, we didn't want to have the perceived underwriting risk on the health care side. So we make sure that when we partnered with our partners that were going to be long-term strategic plays.

We think of it as we get a seller's fee and arguably we're able to charge more for our product. So that's really to give it as a fixed fee type business that we're getting. The economics that we give up is the risk first reward as far as the underwriting on the health side that our competitors do, right? Some years, they're making money, some years, they're losing money. We just want to have a consistent cash flow and earnings pattern.

And then in terms of the geographic bias, once this is fully rolled out, how should we think about geographies in the sense that like, obviously, most of your workers' comp today is in California. Is it going to be a smaller geographic split? Or is there any other moving parts there?

We have workers come in every state, not just California. I would say it's pretty well distributed based upon the way the payroll operations are. California is our largest market. We've got 20 branches there. It's -- I'd rather be big in California than bigger Rhode Island, right?

So -- but when we look at the map, we're able to sell this product everywhere, and we're able to bring on white collar business. I think it was about 25% of the new business we brought on for the health care was in the white-collar space, which is fun and exciting for us, right? That was an industry that was a little more challenging for us to penetrate because of being heavy blue gray with the workers' comp. But we're filling in the map with our market development managers. But as we grow outside of California, we grow in California. So our plan is to ultimately be a national player and be big everywhere.

And then one more for me, and I'll hop back in queue. So gross billings this year around 4%, and you're guiding to 6% to 8% in 2024. Is there a scenario or what would it take to sort of approach double-digit gross billings at some point? Or have you just gotten too large and it's the law of large numbers preventing that?

No. So right, we grew in '23 when our clients were reducing their workforce, right? So as we think of '24 we think our clients are modestly going to hire. And we have that model that it's going to be more in the back half of the year, starting in Q2. But realistically, if our clients higher, we could easily get into the double-digit range.

Our next question is from Jeff Martin with ROTH Capital Partners.

Kramer, I wanted to get into the renewal season, a lot of the portfolio of clients renew in the first 2 months of the year, even some in December, I would assume. November, December, I would assume. Just curious how that renewal period has gone and how the pricing environment is within new and existing clients.

Yes. So this -- good question. So there was a couple first for us, right? So the first was that this was our first 1/1 selling season in California. And I can say I'm pleased with what we did in California. The other first was -- this was our first renewal. So clients that we brought on outside of California for 1/1/23, this was our first renewal. I can tell you that our carriers are happy -- our carriers are honestly ecstatic, and this is why we're able to bring on more carriers this year. They're ecstatic about how well we've done. They're ecstatic about our loss ratio and how good our underwriting is.

But this was our first renewal season, and we renewed -- I want to say it was 94% of the benefits. So we only really had a couple that fell out and they sell out for either an under -- primarily, there were for underwriting reasons that they fell out. But pleased with the operations for what we got done for both new and renewal.

And in terms of the pricing environment on new and renewals?

Inflation is everywhere, right? So you're seeing on the benefit side, the medical cost trend and some of the other drugs that are coming out and driving up the Rx prices. So there was some markets that were up 20%. But us being a new entrant into the game, we didn't have to try to push those 20% rate increases to our clients. What we're able to do is be an alternative for them. And we saw because of the, I'll say, we're still new at this, right? We've -- we don't have a lot of years of experience to talk about it. But I can tell you that we had more submissions and more transactions coming through because the market was charging a higher rate and folks were shopping around.

Makes sense. Sounds like you're looking to continue to kind of bolster up the technology platform for clients. Just curious if there are specific things that you can enlighten us with in terms of strategically what you're doing there? And is this client driven? What is the underlying driver behind further enhancement?

Yes. I would say it's predominantly client-driven as we think of our enhancements to myBBSI, it's really think of that client first and think about the employee life cycle that they have with their employees. And then how do we feel that employee life cycle data, number one? And then number two, how do we push and pull data via APIs and things like that with other sources. So that's kind of the focus so we think of the client first as far as specifics I don't want to give specifics until we actually launch products, and we're going to have products that we're launching later in the year.

Okay. And then last one for me, if I could. On the adjustments to prior year workers' compensation liability and premiums, $13 million last year, roughly $15 million this year. I assume that's going to tail off at some point. How should we think about that for maybe 2024 and 2025 in terms of a potential range? I know it's hard for you to predict. But just in terms of how to think -- how people should think about it from a modeling standpoint.

We're conservative by nature when we set our current year loss rates. And then -- sorry, this is -- I'm going to give you a Kramer answer. I'm going to wander on this one, Jeff. So we have what I call best-in- class structural partners. We've got best-in-class risk managers, underwritings, claims folks, operation, actuarial. We are a very mature organization. We have tech, we have AI that we adopt to help us with all of this. And then we have about 200 folks either directly or indirectly that work on workers' comp at our organization.

We structured these new programs so that the interest is aligned with the market. If things are favorable, the market makes money and then we, as BBSI and as shareholders get money back. We did that because we thought this would be more attractive to investors because it's a derisked model. And we thought that we would get multiple expansion with them.

Our conservatism is in our results. You have to fact check me on this, but I think we've had 20-plus quarters, Anthony?

20.

20 quarters of favorable changes in estimate for prior year liabilities and for premium adjustments. 2024 was our largest in our history. So if you just look at the trend, the trend for that aspect is our friend, right? So we feel like we've set ourselves up that this trend is going to continue. And if you look at '23. That was the largest number we've had in our history.

Our next question is from the line of Vincent Colicchio with Barrington Research.

Yes. Gary, curious how your view of the economy has changed since last quarter? I assume it's a bit better, if I heard correctly, you're assuming that existing clients will hire people will expand their roles in '24.

Yes. If you just think about, call it, our last 18 months of experience, right, from just the payroll exposure. We started to see our clients pull back at Q4 of '22, and they pulled back in Q1 of '23, pulled back some in Q2. The nice thing was in Q3 of '23 was when we started to see it stabilize, slight hiring. In '24, for Q4 of '23, we saw slight hiring as well, right? So we're seeing stability in Q3. We see stability in Q4. And then the numbers that we're seeing so far through January and February is more stability.

So we -- when we look at the business that reduced their workforce, that was primarily in the construction and trades. And if you look at the construction trades, you just look at the housing starts, things are coming back now, and that's what gives us kind of more optimism for our workforce that our clients are going to resume hiring into '24.

And if you double your health care clients by next year, the amount of income that comes in from that, is that what you would have -- let me ask -- what I'm trying to say is, will that be a meaningful amount of income to the company if you hit that goal?

We're not going to guide to just the product line, but we're not doing this for pennies. We're doing it for dollars.

Okay. And then you said you have 15 asset-light programs in place currently. Curious if some of those have already converted to physical locations and how do you feel about opening additional physical locations this year?

Yes. We are in a couple of the markets we're actively searching for real estate, and we are also recruiting to have local support. So in a couple of the markets, we're looking at local HR because we're doing pretty well in those spots. We anticipate that we'll probably have 3 markets that go brick-and-mortar in '24 and then more of that to follow in '25.

Our next question is from the line of Marc Riddick with Sidoti & Company.

So I was wondering if -- with this being the first selling season for first key selling season for BBSI. If you could talk a little bit about the benefits, I'm sorry, for the -- were there any particular learnings or things that have taken place as you've gone through this process thus far that have been slight positive surprise, slight negative. Anything as part of that process that was outside of expectations?

I'd say I'm glad I lost my hair prior to this rollout. It was not a straight line. It was -- we learned a lot of things along the way. Part of what we're doing right now is while it's still fresh, we are having a whole continuous improvement team to go through and understand what do we need to do better on the sales service underwriting for new and renewal. We -- I could say I'm proud of the team, I'm proud of the company, I'm proud of the organization for getting it done. We learned a lot of lessons, but probably good lessons that we can build upon.

Okay. Excellent. Then the other thing was shifting gears a little bit. I was -- sorry, go back to your commentary around the NPS exercise that you did. I thought it was kind of interesting. One, maybe -- you could maybe talk a little bit about what led you to do that? And two, was there any sort of differentiation of certain industry or client verticals that may be scored higher than others? Or was there any -- was that generally across the board with those scores?

Good question. I mean part of this was every year we do a survey, and we get -- surprisingly, we get a lot of folks that utilize it. We get a good sample, right? And we use that to understand what are we doing well, what do we need to do better, what our clients are asking for. And that's how we shape some of the directions that we go with our IT products. It's really we're listening to the clients and they're telling us that. The Net Promoter Score was a good thought from some of our Board. They said if you're doing this, why don't you do the Net Promoter Score. So I honestly didn't know what it was. I had to read it up, but I'm pretty pleased with the results of the survey. I mean it's pretty remarkable to have a score that high. I'm really proud of the work we're doing.

I'm glad you actually called that out that was pretty interesting to hear, so I really appreciate that.

Ladies and gentlemen, at this time, this concludes our question-and-answer session. I would now like to turn the call back over to Mr. Kramer for closing remarks.

Yes. I just want to thank all of our BBSI employees for a great year, and I want to thank all of our clients for partnering with BBSI. I appreciate your time. Thank you.

Thank you. The conference of BBSI has now concluded. Thank you for your participation. You may now disconnect your lines.