Barrett Business Services, Inc. First Quarter 2024 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, 2024. 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 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. This statement provides important questions 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 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 everybody that this call will be available for replay through June 1, 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. Gary Kramer. Please go ahead, sir.

Thank you, and good afternoon, everyone, and thank you for joining the call. I am pleased to report that we had a strong start of the year, and our financial results are in line with our full year projections. We continued to execute our short- and long-term objectives, and we added a record amount of worksite employees for our first quarter.

Moving to our financial results and worksite employee status. During the quarter, our gross billings increased 7% over the prior year quarter and was in line with our expectations. We continue to execute on our various strategies to increase the top of the sales funnel, and we are seeing positive results. We added 11% more WSEs from new client adds than the prior year quarter.

Our client retention continues to trend better than prepandemic 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 controllable growth, is that we added approximately 3,100 worksite employees year-over-year from net new clients. We mentioned previously that we began to see our clients' workforce stabilize in Q3 and Q4. We are pleased to report that our clients began to hire modestly in the first quarter as we were forecasting.

To summarize, for the quarter, we grew our worksite employees by 3.1% as we sold and retained more business and experienced a benefit from our clients' moderate net hiring.

Moving to our staffing operations. Our staffing business declined by 12% over the prior year quarter and was within our expected range. We continue to execute on our strategy to recruit for our PEO clients and placed 79 applicants in the quarter. We are also experiencing macroeconomic factors, including supply and demand imbalances, which vary by geography. As we look to the remainder of the year, we will be going against softer comparables starting in Q2, and we are forecasting our staffing business to stabilize.

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 and largely achieving their goals of adding and servicing new clients and new referral partners. In two of the markets, we have hired additional folks to support our clients and are in the process of moving into a traditional brick-and-mortar BBSI branch. We continue to see positive results from our investments in new markets and are actively recruiting additional new market development managers.

Regarding our product updates, we continue to execute on the sale 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 March, we have approximately 280 clients on our various plans with more than 7,000 total participants.

We continue to invest and evolve our business product offering. Earlier in the month, we announced that we entered into a strategic multiyear partnership with Kaiser Permanente for programs effective 7/1/24 or greater. Kaiser is renowned for its excellence in health care services and offers one of the most complete and competitive HMO products in the marketplace. This offering folds into our workers' comp and health insurance framework where we take no underwriting risk.

The addition of Kaiser will further round out our product offering from blue- and grey-collar clients. We will be offering a national PPO side by side with the Kaiser HMO, and we are receiving positive feedback from our clients and referral partners. We believe that this is going to give us a lift for 7/1, but more importantly, be an accelerant to growth as we look out to 2025 and beyond.

We are pleased with the results of BBSI benefits, and this product will be accretive to earnings in 2024. We are bullish on this product, and we'll now reap the benefit of leverage through scale.

Next, I would like to shift to our view of the remainder of the year. We have consecutive quarters of great momentum. We met our worksite employee expectations. We continue to be optimistic about the road ahead. We have consistently achieved strong controllable growth by focusing on the needs of our clients and by adding new clients. We have more product to sell, more folks selling it and more referral partners recommending BBSI.

[Technical Difficulty]

Your phone is cutting out on us.

Thank you, Gary.

Can you hear me now?

Yes.

Okay. Shall I continue?

Yes, go ahead.

Okay

We’re already at the transition.

I know, it’s a good time now that we’ve had a little intermission.

Thank you, and hello, everyone. I'm pleased to report we finished Q1 with strong results, consistent with our plan and with continued positive momentum in our sales pipeline. Gross billings increased 7% to $1.9 billion in Q1 '24 versus $1.8 billion in the prior year quarter. PEO gross billings increased 7% in the quarter to $1.89 billion, while staffing revenues declined 12% to $20 million in the quarter. Our PEO worksite employees grew by 3.1% versus the year ago quarter, which is the result of strong controllable growth from net new PEO clients as well as modest hiring within our existing customer base.

Looking at trends in client hiring more closely, we saw moderate positive hiring in every region, except for the Northwest region. The Northwest continues to be most impacted by declines in the construction sector, while all other regions are now seeing modest increases in construction hiring on a year-over-year basis. The pace of hiring remains broadly slower than historical trends across all regions, but it is in line with our expectations.

Looking at hours worked, overtime hours per employee have remained stable. And for the second quarter in a row, total overtime hours worked were higher than the prior year quarter. Wage rates continue to increase and average billing per WSE increased 3.5% in the quarter.

Looking at PEO gross billings growth by region versus the prior year first quarter, East Coast grew by 17%, Mountain States and Southern California both grew by 7%, northern California grew by 4% and the Pacific Northwest declined by 6%.

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 Q1 '24, we recognized favorable prior year liability and premium adjustments of $3 million compared to favorable adjustments of $1.1 million in the first quarter of '23. As a reminder, our client workers' compensation exposure is now primarily covered by our fully insured program with no retained liability by BBSI.

Payroll taxes are typically highest in Q1 as wage caps reset, and this year has seen a modestly higher effective client unemployment tax rate than recent years. These higher rates are reflected in our billing rates over the course of the year and our gross margin rate remains in line with expectations, both for the quarter and the year.

Our overall profitability has continued to benefit from operating cost management.

For Q1, SG&A expense increased by approximately 3%, growing slower than our billings growth rate and providing ongoing operating leverage.

Moving to investment income. Our investment portfolios earned $3.2 million in the first quarter, up $0.9 million from the prior year. Our investments continue to be managed conservatively with average quality of AA and average book yield of 2.9%.

Net loss for the first quarter was $0.1 million or $0.02 per diluted share compared to net income of $0.8 million or $0.12 per diluted share in the year ago quarter. This decrease is primarily attributable to an increase in payroll taxes, partially offset by decreased workers' compensation expense and the increase in investment income.

Our balance sheet remains strong with $124 million of unrestricted cash investments at March 31 and no debt. We continue our approach to capital allocation, making investments back into the company through product enhancement and geographic expansion and distributing excess capital to our shareholders through our dividend and stock buyback plan.

Continuing under the Board's July 2023 repurchase program BBSI repurchased $7 million of shares in the first quarter at an average price of $120 per share with $52 million remaining available under the program at quarter end. The company also paid $2 million in dividends in the quarter and reaffirmed its dividend for the following quarter.

The Board also announced their intent to execute a 4-for-1 stock split, pending approval by shareholders as a related increase in the number of authorized shares. Executing the stock split is intended to increase our flow, benefiting liquidity and trading efficiency for our shareholders and speaks to our optimism about the long-term value of our company and our trajectory. The effective date of the split is expected to be in June, pending the results of the shareholder vote.

Looking to our outlook for the full year. Our results for Q1 are in line with our plan and our expectations for 2024 remain consistent with our prior outlook. We continue to expect gross billings to increase to 6% and 8% for the year. We expect average WSEs to increase between 4% and 5%. We expect gross margin as a percent of gross in to be between 2.95% and 3.15%. And we expect our effective annual tax rate between 26% and 27%. I will now turn the call back to the operator for questions.

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

I guess let's dive in by starting with the gross billings growth. Obviously, guidance is reiterated with 4% to 5% WSE growth. That implies pretty low wage inflation and pretty modest net hiring, I would assume. Just curious if you could elaborate on those items.

Yes, I think you're correct. I think we went into this expecting really flat -- last year, we saw a net negative client hiring. This year, we're expecting modest growth. We've seen that modest growth. We've messaged that to the extent that there is upside in economic activity, particularly in the construction sector, that would be a benefit to our billings growth.

Yes. I would say the lion's share of our revenue growth is going to come from our controllable growth this year, right? So we've got a good track record over the last couple of years of adding and retaining business, and that's really going to carry us forward in '24. And then if the economy picks up and our clients start to hire again, that's just a tailwind that's not really baked into our forecast.

Yes. And then if I recall correctly, you had at the end of Q4, you had 275 clients on the health care plan. We just ended a renewal period for 1/1 renewal, now we're at 280. Is there something I'm missing here? Would think you'd see a pretty significant step up from Q4 to Q1 in terms of clients on the health care plan.

So when I -- good question. When I gave those stats last earnings call, I gave them as of end of January. So I was trying to show the investment community how successful we were for the 1/1. So really, all we're taking credit for now in this roll forward is February and March, which I think is like a small amount of clients because they're not real big health care modes.

Got it. Okay. And then in terms of the July 1 kickoff with Kaiser, just curious what kind of initial expectations we should expect.

I don't want to tell you what I expect because I expect too much. So I won't -- I'll temper this some. 7/1s are launched for the program. We started to market and sell it in April. It's still early, right? So we're 4 weeks into the selling season for 7/1. We've quoted 60-plus some deals so far, and we've got more in the queue to quote. We've got about 10 that we've closed so far for 7/1.

But I would say that this is specifically in the geographies we're in, right? Because if you look at California and you look at Oregon, there are 2 pretty heavy Kaiser states. And then the interesting part about Kaiser is I feel like folks are born into it and they're raised into it. And when they become adults, they want to have it as well because it's what they know and what they trust. They really built a good brand, and we're just pleased that we can put the BBSI brand next to the Kaiser brand plus with the national partner for the PPO, we think it really rounds out the offering in those states.

And 7/1 is our second biggest season. But really, this is, I'll say, learning the craft and the dance with Kaiser so that when we get to the 1/1 for '25, we could be successful and set ourselves up for a good '25.

Great. And then just one more, if I could, and then I'll circle back around. But in terms of the Kaiser offering, is it -- am I understanding correctly, it's HMO only? And curious if it doesn't include PPO, why isn't that an option?

We have a very competitive PPO on our national partner. So really when we put the product offering out there, they can buy -- the clients have the opportunity to buy the PPO on our national or if they would like the HMO and Kaiser. Kaiser predominantly sells in this small business space, it's -- the lion's share is predominantly the HMO.

Our next question is from Chris Moore with CJS Securities.

Maybe I'll just start with the benefits where Jeff left off. I just want to make sure that I understand the enrollment process. So it's July 1 with Kaiser, there will be ongoing enrollment during '24, but there's a bias towards starting on January 1. Just trying to understand how that works.

Yes, the lion's share for health insurance -- I said lion's share 3 times already. But the lion's share for health insurance is effective 1/1, and part of the reason for that is it ties into the HSA accounts. Where you don't have HSA, it's less beholden to a 1/1 effective date. But 1/1 is the biggest effective date, 7/1 is the second largest effective date. And then it kind of -- it's kind of smatters in from there by month. I mean we add clients every month. But a large portion of them will be 7/1 and 1/1.

Got it. Maybe we could talk a little bit more about the asset-light model. It sounds like within the 15, there's potentially 2 kind of traditional BBSI branches that are beginning to form? Is that right? And roughly where is that geographically?

Yes. So we've had a -- first, we've got a good client base there, and we're covering the cost of the program. So we make additional investments. And the first investment we make is typically, it's been so far we hire HR professional locally. And then we also then build out a true branch, a BBSI brick-and-mortar, as we call it. So in 2 of the markets, we've hired additional folks locally to support our clients, and we're in the process now of tenant improvements and moving into Dallas and Chicago.

Got you. Very helpful. And maybe just the last one for me. Can you maybe talk about the cadence of earnings Q2 and Q4? Is it -- I think in the past, it's often been Q2 and Q4 kind of in that same range and Q3 a little bit higher. Is that the way we should be looking at it now? Is there anything kind of different at this stage?

Yes, a similar pattern. Our operations peak seasonally in Q3, and that's when we see our highest profits. Usually, Q2 and Q4 would be similar, little weighting more towards the back half of the year, this is where we put our trending. But yes, that's right. Q1, we obviously have very low margins because of the payroll taxes, as I mentioned.

Our next question is from Vincent Colicchio with Barrington Research.

Yes, Gary, I'll let you finish your comment. You were cut off on the -- all I heard was the economy. I suppose you were going to discuss your thoughts on the economy versus last quarter.

I guess I had my Forrest Gump moment there. But the way we're looking at the economy, there was no material change in Q1 versus Q4. And when we're looking ahead, we're saying if the economy trades the way -- behaves the way it is now, we still anticipate greater gross billings growth in '24 than in '23, which is obviously reflected in our higher guide for '24 than what we realized for '23.

And a follow-up on the asset-light model. Of the remaining programs that are not moving to an office. And if I've heard you right, 2 are moving to an office, right? Do you expect any of them to also move to that next stage this year?

I mean, ultimately, we expect all of them to graduate to a BBSI branch. It's just a question of when. And that has to do with what their profitability and sell-through rate is. I'd have to get back to -- I'll speak to that next quarter, maybe I'll lay out a better projection for how we think the end of '24 and '25 is going to go for physical branch building.

And I think you said last quarter, you would add 3 more asset-light markets. Is that accurate?

It's an evolving number because we hired two and one doesn't make it type of thing. So really, it's a fluid number where we hire everybody. We have a good compensation package. We train folks. We give them immersion training, we go into the market and help them. And ultimately, we try to make sure that they're successful. But it's a tough job, and there's some that are successful and we had a few that haven't been. But when they're not, we backfill and start again. So it's -- sometimes it's 3 steps forward, one step back.

And last question. As you roll out this health care product, are you getting better at adding large clients? What does that progression look like?

It's -- if you don't mind, ask me that next quarter when I actually had this -- when we have 7/1 under our belt. Right now, I'm still looking ahead. And we don't -- most of the folks don't make their buying decision for 7/1 until May or middle of May. So we have a lot of folks that we've presented to that we think we have a chance to win. But ultimately, they haven't given us the order yet. When we get to next quarter, we'll have a true tally of what our 7/1 results were.

Our next question is a follow-up from Jeff Martin with ROTH Capital Markets.

I wanted to ask about payroll taxes. I know state unemployment rates had remained low for an unusually sizable period of time, and it appears the states are catching up to that now. I'm looking at gross margin down about 25 basis points year-over-year. You did comment that it was in line with your internal budget expectations. But just curious, with strong pricing that you're experiencing, this would imply that you get more of a trampoline effect in the later part of the year when you get [through the gaps.] Just curious if you could comment on that.

Yes, you're spot on there. So higher payroll tax, really, across every region for us and our clients, just the trend you had said that was -- and we've seen payroll tax rates coming down with the strong economy in the last couple of years. And even after COVID, a lot of states put policies in place to really abate all of the effects of the COVID layoffs, right? But now with the term, we are seeing higher rates. We do bake that into our pricing. But as you noted, that will flow through over the course of the year. So it will be somewhat of a trampoline effect, as you noted, a little lower margin than usual in this quarter and that will rebound over the next 3 quarters.

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.

Well, thank you, everybody, for dialing in. I would like to thank all the BBSI professionals for their hard work. We had a great quarter and a great start of the year. And just thank you, everybody.

Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.