

Rollins, Inc.
First Quarter 2024 Earnings Conference Call
April 25, 2024

Presenters

Lyndsey Burton, Vice President of Investor Relations
Jerry Gahlhoff, President and Chief Executive Officer
Ken Krause, Executive Vice President, CFO and Treasurer

Q&A Participants

Timothy Mulrooney - William Blair
George Tong - Goldman Sachs
Unidentified – Jefferies
David Pekon (Ph) – RBC Capital Markets
Josh Chan - UBS
Ollie Davies - Redburn Atlantic

Operator

Greetings. Welcome to Rollins, Inc. First Quarter 2024 Earnings Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press “*”, “0” on your telephone keypad.

Please note, this conference is being recorded.

I will now turn the conference over to Lyndsey Burton, Vice President of Investor Relations. Thank you. You may begin.

Lyndsey Burton

Thank you, and good morning, everyone. In addition to the earnings release that we issued yesterday, the company has also prepared a supporting slide presentation. The earnings release and presentation are available on our website at www.rollins.com.

We have included certain non-GAAP financial measures as part of our discussion, this morning. The non-GAAP reconciliations are available in the appendix of today's presentation, as well as in our earnings release.

The company's earnings release discusses the business outlook and contains certain forward-looking statements. These particular forward-looking statements and all other statements that have been made on this call, excluding historical facts, are subject to a number of risks and uncertainties, and actual results may differ, materially, from any statement we make today.

Please refer to yesterday's press release and the company's SEC filings, including the Risk Factors section of our Form 10-K for the year ended December 31, 2023.

On the line with me today and speaking are Jerry Gahlhoff, President and Chief Executive Officer, and Ken Krause, Executive Vice President, Chief Financial Officer and Treasurer.

Management will make some opening remarks, and then we'll open the line for your questions. Before I turn it over to Jerry, I want to remind everyone of our upcoming Investor Day on May 17 in New York City. We're looking forward to hosting the investment community and discussing our strategies for growing our business and driving value for our stakeholders. Jerry, would you like to begin?

Jerry Gahlhoff

Thank you, Lyndsey. Good morning, everyone. I'm pleased to report that Rollins delivered another good quarter of growth and profitability, reflecting consistent execution of our operating strategies and continuous improvement in our business.

Our financial performance for the first quarter was highlighted by an increase in revenue of nearly 14% to \$748 million. We delivered healthy organic growth of 7.5% in the quarter, despite some unfavorable and erratic weather in January, compared to last year, which Ken will discuss in more detail.

Overall, we continued to see double-digit revenue growth across all major service lines as total Residential revenue increased 16.5%, Commercial rose 11.4% and Termite was up 11.7%, this quarter.

We continue to invest in growing our business. As you would expect, we invested in incremental sales staffing and marketing activities ahead of peak season to ensure that we are well-positioned and top of mind for the consumer, as pet season begins. We are well staffed on the technician and customer support front, so that people are onboarded, extensively trained and ready to provide an exceptional level of service for our customers.

On the Commercial side of the business, we are leveraging analytics to identify areas in the market where opportunity warrants additional resources. And this continues to pay dividends, as evidenced by another quarter of double-digit Commercial growth.

We continue to, strategically, add feet on the street to our sales force and are leveraging our training and sales tools to better enable their success, as well.

Investments to drive organic growth are complemented by strategic M&A. April 1 marked the 1-year anniversary of closing the Fox acquisition, and that team has performed exceptionally

well. We anticipate that Fox will continue to positively impact organic growth and profitability, as we go forward.

We closed 12 tuck-in deals in the first three months of the year, and the M&A pipeline remains healthy. We're actively evaluating acquisition opportunities, both domestically and internationally, and remain on track to deliver at least 2% of growth from M&A activity in 2024.

Beyond growth, our dedication to operational efficiency and continuous improvement is an important part of our strategy and culture. Ken will discuss in more detail, but we saw a healthy margin improvement in the quarter as we executed our pricing strategy, leveraged our cost structure and drove efficiencies throughout the business.

Safety remains an important area of focus for us, and efforts to enhance safety coaching, training and protocols resulted in higher driving safety scores and fewer recorded safety incidents, when compared to a year ago.

In closing, we're excited about where our business stands, today. This year is off to a solid start, and demand from our customers remains strong with over 7% organic growth in the first quarter.

Our markets are solid, staffing levels are healthy, and our team is focused on driving continuous improvement and profitable growth. I want to thank each of our 19,000-plus team members, around the world, for their ongoing commitment to our customers.

Before I hand it over to Ken, I'd like to announce a few changes to our Board of Directors. First, we would like to thank Jerry Nix, who recently retired from our Board, for his service to our company. We've been so fortunate to have Jerry as our Lead Director for the past several years. His experience, wisdom and guidance helped us navigate uncharted waters for our company, and we're incredibly grateful for the significant contributions he's made, along the way.

Second, we would like to welcome Dale Jones, who was elected to our Board at a recent shareholder meeting. Additionally, Louise Sams has been appointed as our new Lead Independent Director. We're excited about the level of expertise and experience that both Dale and Louise will bring to our Board in their new roles.

Ken, I'll now turn the call over to you.

Ken Krause

Thanks, Jerry, and good morning, everyone. The first quarter reflects continued strong execution by the Rollins team. A few highlights to start.

Growth was robust at the start of the year. We delivered revenue growth of 13.7%, year-over-year. Organic growth was 7.5%, and we saw significant improvement moving throughout the quarter, as organic revenue growth accelerated to over 10% for February and March.

Adjusted operating margins were 18.4%, up a healthy 130 basis points with strong gross profit performance and solid expense leverage, despite incremental investments aimed at growing our business.

Cash flow continues to be very strong with free cash flow increasing 29%, enabling a balanced capital allocation strategy.

Diving further into the quarter, we saw good growth across each of our service offerings. In the first quarter, Residential revenues increased 16.5%, Commercial pest control rose 11.4% and Termite and ancillary increased by 11.7%. Organic growth was also healthy across the portfolio, with growth of 4.3% in Residential, 10.1% in Commercial and 9.3% in Termite and ancillary.

As Jerry mentioned, our Residential organic growth was impacted by a slower start in January. To provide context, February and March total organic growth was a very strong 10.8% versus 7.5% for the quarter. And looking at Residential revenue specifically, February and March organic growth was a healthy 8% versus 4.3% for the quarter. We are pleased with the consistent growth we continue to see, across the business.

Turning to profitability, our gross margins were healthy at 51.2%, up 90 basis points versus last year. We continue to be positive on the price cost equation and saw good performance across several key cost categories. While Fox was accretive to gross margins for the quarter by about 40 basis points, organic margin improved 50 basis points, as we saw nice leverage from people cost, fleet and materials and supplies.

Quarterly SG&A costs as a percentage of revenue decreased by 10 basis points versus last year. Excluding the earnout adjustment for the Fox acquisition, SG&A cost as a percentage of revenue decreased by 20 basis points in the quarter.

We saw healthy leverage from administrative-related costs, which enabled reinvestment and incremental advertising and selling expenses associated with growth initiatives that Jerry discussed.

First quarter GAAP operating income was \$132 million, up 18%, year-over-year. Adjusted operating income was \$138 million, up nearly 23% versus prior year on approximately 14% total revenue growth.

Adjusted operating margins were 18.4%, up 130 basis points, year-over-year, on strong gross margins, coupled with solid expense leverage.

First quarter EBITDA was \$160 million, up over 14% and representing a 21.3% margin, up 10 basis points versus last year.

You'll recall that, last quarter, we called out a negative impact to adjusted EBITDA due to lower nonoperational gains versus the comparable period in the prior year. We saw a similar dynamic in the first quarter, as well. Given that we do, from time to time, divest nonoperational assets, we have made the decision to exclude gains and losses on these types of sales.

Adjusted EBITDA, adjusted net income and adjusted EPS are measures of operating performance, and this change will allow us to better compare our underlying performance more consistently, over time.

A table showing the revised metrics for fiscal 2023 is included in our earnings release. First quarter adjusted EBITDA was \$161 million, up 19% versus last year. Adjusted EBITDA margin of 21.5% was strong, improving 100 basis points, driven by leverage across the P&L.

Incremental adjusted EBITDA margin was 29%, a healthy result considering that Q1 is a slower period and can have a lower profitability profile as we invest ahead of our busier seasons. The effective tax rate was approximately 24% in the quarter, in line with the prior year.

Quarterly GAAP net income was \$94 million, or \$0.19 per share, increasing from \$0.18 per share in the same period a year ago. For the first quarter, we had non-GAAP pretax adjustments associated with the Fox acquisition-related items totaling approximately \$5 million of pretax expense in the quarter.

Accounting for these expenses, adjusted net income for the quarter was \$98 million, or \$0.20 per share, increasing over 17% from the same period a year ago, despite the higher level of interest cost on the higher debt balances versus the comparable period.

Turning to cash flow and the balance sheet, operating cash flow increased 27% in the quarter to \$127 million. We generated \$120 million of free cash flow, a 29% increase versus last year. Cash flow conversion, the percent of income that was converted into operating cash flow, was well above 120% for the quarter.

We made acquisitions totaling \$47 million, and we paid \$73 million in dividends, both up versus the same period a year ago.

Debt-to-EBITDA leverage is well below 1x on a gross and net level, and our balance sheet is very healthy and positions us, well, to continue to execute on our capital allocation priorities.

In closing, our performance this quarter continues to demonstrate the strength of our business model and the engagement level of our teams. Demand is healthy and our acquisition pipeline

provides us a sense of optimism. We remain focused on providing our customers with the best customer experience and driving growth, both organically and through disciplined acquisitions.

With that, I'll turn the call back over to Jerry.

Jerry Gahlhoff

Thank you, Ken. We're happy to take any questions at this time.

Operator

Thank you. If you would like to ask a question, please press “*”, “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “*”, “2” if you would like to remove your question from the queue. And for participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys.

Please ask one question and one follow up question and re-queue for additional questions.

Our first question is from Timothy Mulrooney with William Blair. Please proceed.

Timothy Mulrooney

Ken, Jerry, good morning.

Ken Krause

Good morning.

Jerry Gahlhoff

Good morning.

Timothy Mulrooney

So just stepping back here, with trends accelerating in February and March, I just wonder if folks are going to extrapolate that 10% organic growth rate into the next several months and quarters. I mean, 10% to me, just sounds like touch on the strong side. So, I wonder if that's how you're thinking about things or if expectations are better level set to kind of what we saw over the last several quarters, more in that 7% to 8% range for organic growth.

Ken Krause

Thanks for the question, Tim. I appreciate that. And when looking at the business, we certainly did see some improvements as we went throughout the quarter. But one quarter is certainly not a long-term trend. We are continuing to remain very confident in our outlook, and that outlook is really anchored around 7% to 8% sort of growth rate that we've, consistently, talked about.

That stepped up, as you all know, since COVID, and we continue to benefit from that higher growth rate and more favorable operating environment. But yeah, I think 7% to 8% is kind of how we think about the business from an organic basis, going forward.

Timothy Mulrooney

That's really helpful. Thank you, Ken. And this is not a follow-up. It's a completely separate topic, but I'm going to do it, anyway. The step-up in sales and marketing expense, okay? I think there's a couple of different ways folks could interpret that, either as more of a defensive move, because you're having to spend more, maybe on digital marketing to win customers or more as an offensive move, hiring more sales folks for future growth, for example. Could you just double click into that increase in sales and marketing expense column and help us understand that decision a little better to ramp up spend there? Thank you.

Jerry Gahlhoff

Tim, this is Jerry. A lot of that cost really lied on the heavier side on the selling expense as it relates to us staffing up. Let me give you a couple of examples, a couple of data points. Just looking at Orkin alone, when we looked compared to prior year in the first quarter, we had over 50 more Commercial account managers at Orkin, alone. We had over 100 more home sales inspectors at Orkin in the first quarter of this year than we did the last year.

So that's where a lot of our investment continues to be. We see that opportunity. That's what I referred to as the feet on the street opportunity. So our sales salaries are up there. It's not necessarily some sort of targeted defensive marketing spend. It's an offensive sales mobilization and really building out your sales team for the growth opportunities ahead.

Timothy Mulrooney

Got it, makes sense. Thank you.

Jerry Gahlhoff

Thank you.

Operator

Our next question is from George Tong with Goldman Sachs. Please proceed.

George Tong

Hi, thanks. Good morning. I wanted to dive into trends that you're seeing in the Residential business. It sounds like most of the impact to organic revenue growth in Residential was due to unfavorable January weather, leading to the 4% organic growth. I wanted to see if there were any other trends you would call out there? I know last quarter, you highlighted onetime sales impact. So, any changes there and other operating items to consider as it relates to the organic growth in Residential?

Ken Krause

Certainly. When we look at the Residential business, we look at the Residential business very broadly across our Residential services, as well as our Termite and ancillary. Across that portfolio, the business continues to perform very well. Onetime business can be choppy. It continues to be choppy. But generally, demand for our services remains very healthy.

As I indicated in my prepared commentary, what we saw when we look just at the Residential business alone, we saw an improvement, 4.3% growth for the quarter but close to 8% growth as we look at February and March. So we continue to see really good demand levels for our business.

Jerry Gahlhoff

I would add to that, George, that when we think about some of the onetime business as well, as Ken mentioned, it's usually choppier in the shoulder seasons when weather--that's an area of the business that weather can impact more so than anything, but you still have your recurring customer base that's there to service. But we also continue to see really strong health in our onetime ancillary business that really shows that the consumer side of it is strong and the consumers continue to be willing to invest in protecting their homes.

George Tong

Got it. That's helpful context. And then within the Termite and ancillary services business, organic growth seems to have decelerated a bit to 9%, compared to 11% in 4Q. Can you talk about some of the puts and takes that could have led to that performance?

Ken Krause

Certainly, when you unpack the Termite business, there's two components to the Termite and ancillary. There is your normal recurring Termite business, your pretreat business, and then you have ancillary business in there, as well. We're seeing really good demand across the spectrum.

Our business, our recurring bait monitoring business, continues to grow at a very healthy level, but also our ancillary business in that area continues to grow, as well, at a nice rate. So it's really a broad-based growth that we're seeing in demand for our services.

George Tong

Okay. Got it. Any factors that could have caused the deceleration in organic revenue growth there?

Jerry Gahlhoff

I look at it from a productivity standpoint. We continue to--the sales are there, the working the backlog can be a challenge. And in the quarter--and that goes back to a January type of phenomenon, where we had more branches and operations closed for multiple days, compared to the prior year. And that affects productivity and ability to get the work done, even if our sales force is out there selling and they're out there continuing to do what they do and building that backlog of work to get done.

And so, the work is there for us to get done, so we're optimistic about that. It's not a selling issue. It's us getting all the workload done in a given period of time. So when you carry a backlog over into the second quarter, things still look healthy, if that helps to add any color.

George Tong

Got it. Very helpful. Thank you.

Operator

Our next question is from Stephanie Moore with Jefferies. Please proceed.

Unidentified

On for Stephanie Moore. I just wanted to touch on Commercial organic growth that's been pretty strong over the last few quarters. And I know you mentioned leveraging analytics and things like that, but I was just curious if there's anything else to call out and if you could kind of talk about the sustainability of growth there.

Jerry Gahlhoff

I know it sounds like a broken record, and we've said this now for a few years, we just continue to invest in our sales staff, getting them ramped up and being successful. That is a B2B sales process is a relationship type of sale. It's got a long selling cycle, and you got to be patient, you got to invest. You got to invest in training and sales tools and supporting those new account managers when they're brought up to get them ramped up and brought to speed, just as fast as possible.

That is the more you add in the sales force and the more investments you make to make them successful, we just continue to see that opportunity there. So I wouldn't say there's anything magical about it other than being committed to continue to add, incrementally, to our sales force.

Ken Krause

It's interesting, when I step back and I look at the financials, and I look at the trend in spend across different categories of SG&A, Jerry is spot on, sales salaries continues to be an area that we continue to invest, disproportionately, in. We're saving money in some of the back office costs and admin areas, but we continue to invest pretty heavily on the front end of our business and taking a very offensive perspective on our business.

Unidentified

Just on the resi side, have you guys seen any slowdown, anything that's meaningful related to the new business wins or a sort of meaningful pickup in customer churn and maybe lower household income areas? And then just anything you could share around how April is kind of shaping up, so far.

Jerry Gahlhoff

We haven't seen any significant change from a retention issue, one way or the other. So that remains pretty solid and any color on April?

Ken Krause

It would be very difficult to grow our business at the rate we're growing if we saw kiting in customer churn. And so customer churn, although it is not kiting, it still remains an opportunity for us to continue to improve. When we look at April, we continue to see healthy levels of demand. We're starting April, strongly. But again, we continue to think about a 7% to 8% sort of organic growth rate across the business, as we think about the future.

Operator

Our next question is from Ashish Sabadra with RBC Capital Markets. Please proceed.

David Pekon

This is David Pekon (Ph) for Ashish. Good morning. In terms of capital allocation, now that you've lapped the Fox acquisition, how should we think about, I guess, your M&A pipeline in terms of larger deals or smaller deals going forward, especially given this robust free cash flow that you keep generating? Thank you.

Ken Krause

When we look at the pipeline, it's very healthy. It's very balanced. There's opportunities across the spectrum with respect to M&A. Something that we have consistently said, however, for 2024, is that we do think that 2% to 3% of revenue growth is probably a realistic expectation of contribution from M&A.

We continue to look at deals. We continue to evaluate deals. And in fact, in Q1, we spent roughly \$45 million to \$50 million on M&A, and that was up considerably, year-over-year. Of course, last year, we were preparing for Fox. But I think it just shows that there continues to be a very healthy pipeline of M&A in a very fragmented market that we continue to compete in.

Operator

As a reminder, it is “*”, “1” on your telephone keypad, if you would like to ask a question. Our next question is from Josh Chan with UBS. Please proceed.

Joshua Chan

Hi, good morning, Jerry and Ken, Lyndsey.

Jerry Gahlhoff

Good morning.

Joshua Chan

Good morning. So I guess you mentioned that 7% to 8% is sustainable growth rate. And given how strong Commercial and Termite is, does that imply that you expect Residential to kind of remain in this 4% range, going forward? Just curious how you're thinking about how the different businesses contribute to that 7% to 8%. Thank you.

Ken Krause

You know, it's interesting, when you start to put a fine point on that, but we do think that probably Commercial and Termite and ancillary will probably grow a little bit faster than the overall average, and resi might grow a little bit slower. You just have puts and takes across the portfolio. It doesn't mean that we're not bullish in Residential, but I just think that that's generally how the growth profile has unfolded, over time for us.

Jerry Gahlhoff

Yeah, I agree with you, Ken. I think it's hard to predict that. I mean, there's going to be movement in any of those categories potentially based on a number of factors and where it all comes out in that 7% to 8% total.

Joshua Chan

Yeah, thank you, okay. That helps. Good color there. And then on your decision to accelerate investment during the off season. Sometimes, you focus on the peak season to invest, sometimes you invest ahead of the season. So could you just talk about the rationale for investing ahead of the season this year, what you're seeing and what opportunities you expect to realize? Thank you.

Ken Krause

Yes. As we had talked about, I mean, the business started to grow pretty nicely on a year-over-year basis, organic basis in February and into March. And so we saw that, and we saw an opportunity to pull forward some investments. It doesn't mean that we're going to invest any lighter in Q2. In fact, we're going to continue to invest in Q2 and drive further growth.

The market opportunity is there, and you've got to invest when that market opportunity is there. This is a very short cycle business. And when you see weather patterns that improve or demand trends that might change, you have to be ready to invest. And so, I think that's just, it's just reflective of our investment and our interest in investing and growth, across our portfolio.

Jerry Gahlhoff

We had a lot more carrying costs from people side in late fourth quarter and certainly in the first quarter than I think we've ever had. The reality is it's certainly harder to find people and then with the level of intensity that we put and the time and energy that we put into training and development upfront, that takes time to have people ready. And so, our strategy has been to get ahead of that.

Joshua Chan

Absolutely. Thank you so much for your time and congrats on the good quarter.

Jerry Gahlhoff

Thank you, Josh.

Operator

Our next question is from Ollie Davies with Redburn Atlantic. Please proceed.

Oliver Davies

Hey, good morning. Just two for me. So firstly, can you just talk about the level of price increases you're putting through and if you're seeing any pushback on the Residential side, just given the level of volume growth in the first quarter? And then secondly, in terms of--probably one for Ken--just in terms of the SG&A. I mean, obviously, the admin expenses, I guess some of that is coming from the modernization that you did, last year. So how sustainable are they going forward through this year and, I guess, your ability to reinvest that?

Ken Krause

So, looking at your questions, thank you for your questions. The first question with respect to pricing, it's interesting. When we step back and we look at this business, I think recently, you've heard me start to talk about this as a CPI-plus type of business. So we think this service is certainly an essential service and should command CPI-plus level pricing. So 3% to 4% this year is certainly--it's something we passed along, and we're seeing it stick. We just feel like the service is just too valuable not to price it at those levels.

And then secondly, when you look at the SG&A levels across the business, it's good to see the improvements that we're seeing in our cost structure. I think in the quarter, we talked about a 20 basis point improvement in SG&A, as a percentage of sales. But when you unpack that, you see that we spent roughly 50 basis points more on growth-oriented investments but 70 basis points less of back office costs.

And I think that's representative of the work we're doing to improve the effectiveness and the productivity of our business. We feel like there's more to come, but we certainly are happy with the progress we're making there.

Oliver Davies

Okay, thanks.

Operator

And our next question is from Ashish Sabadra with RBC Capital Markets. Please proceed.

David Pekon

Hey, sorry, David again. Apologies if I missed this one, but what was the exit growth for Residential? I believe the 10% was for the entire company, but what was it for resi?

Ken Krause

Yeah, it was 10.8% to put a fine point on it for the entire company. And for Residential, it was 8%.

David Pekon

Thank you.

Jerry Gahlhoff

For February and March.

Ken Krause

Yeah, for February and March, yes.

Operator

We have reached the end of our question-and-answer session. I would like to turn the conference back over to management for closing comments.

Jerry Gahlhoff

Thank you, everyone, for joining us, today. We appreciate your interest in our company and look forward to speaking with you all at our upcoming investor conference. Thanks again.

Operator

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