

## Barrett Business Services, Inc. Third 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 third quarter ended September 30, 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 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 December 6, 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](http://www.bbsi.com).

Now I would like to turn the call over to the President and Chief Executive Officer of BBSI, Mr. Gary Kramer. Sir, please go ahead.

Thank you. Good afternoon, everyone, and thank you for joining the call.

I am pleased to report that we had a strong third quarter. Our financial results exceeded our expectations, and we have greater optimism in our full year results. We continue to execute our short- and long-term objectives, and we added a record number of worksite employees from our controllable growth.

Moving to our financial results and worksite employees. During the quarter, our gross billings increased 9% over the prior year quarter, which is greater than expected. We continue to execute our various strategies to increase the top of the sales funnel, and we achieved a record number of worksite employees from new client adds during the third quarter.

Our client retention continues to trend well and is in line with our expectations. 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 4,600 worksite employees year-over-year from net new clients.

The economy in the third quarter remained relatively consistent with the first half of the year. Our clients' workforce continued to modestly grow in the third quarter and into October. To summarize, for the quarter, we grew our worksite employees by 5% as we sold and retained more business and benefited from our client net hiring.

Moving to our staffing operations. Our staffing business declined by 2% over the prior year quarter. We previously mentioned that in 2022, we repriced the portfolio and jettisoned clients where we were not achieving an adequate return. We also shifted our strategy to recruit for our PEO clients, which generated equal margin to our traditional staffing model, but resulted in less top line revenue. This quarter is the first clean quarter-over-quarter comparison, and we are seeing our staffing business stabilize. We continue to execute our strategy to recruit for our PEO clients and placed 105 applicants in the quarter.

Moving to the field operational updates. We're very pleased with our entrance into new markets with our asset-light model. We have 21 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 3 of the markets, we have hired additional local talent to support our clients, and we are in the process of moving into traditional brick-and-mortar BBSI branches. We continue to see positive results from our investments in new markets and are actively recruiting additional new market development managers.

Regarding product updates, we continue to execute on the sale and service of BBSI Benefits, our new health insurance offering. We previously mentioned that we entered into a strategic multiyear partnership with Kaiser Permanente and are now successfully selling their HMO side-by-side with our national PPO. And just like our workers' compensation and existing health insurance offering, we take no underwriting risk. Our new business resulted in more new subscribers in October and November than over the same prior year period. I am pleased to report that today, we have approximately 480 clients on our various medical plans, servicing more than 11,000 total participants.

We are in the thick of the 1/1 selling season, and our business teams are offering BBSI Benefits to our existing clients as well as potential new clients. It is still too early to provide any definitive guidance for 2025, but we are pleased that our current pipeline for 12/1 and 1/1 opportunities are about 35% greater compared to this time a year ago.

As we look forward to 2025, we are confident that this product will be accretive to earnings. We have the people, the product, the technology and the experience to be confident in our various offerings. We are bullish on this product, and we'll begin to reap the benefit of leverage through scale.

Next, I'd like to shift to our view of the remainder of the year and into 2025. We have a solid track record of selling and servicing through uncertain economic times, and our blue, gray clients are proving to be resilient. We are consistently growing our WSE stack, and we ended Q3 with a record number of worksite employees. 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.

It is important to note that there is 1 less business day in 2025. If there is no dislocation in the economy and we close out the year in a manner that I believe we will, then we expect gross billings growth in 2025 to be similar to 2024.

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

Thanks, Gary, and hello, everyone. I'm pleased to report we finished Q3 with strong results and continued momentum in our sales initiatives.

Gross billings increased 9% to \$2.14 billion in Q3 '24 versus \$1.96 billion in the prior year quarter. PEO gross billings increased 9% in the quarter to \$2.12 billion, while staffing revenues declined 2% to \$21 million in the quarter.

Our PEO worksite employees grew by 5% versus the year-ago quarter which, as Gary noted, was driven by a record number of WSEs added from new clients both on a gross basis and net of client runoff.

The continued strong trend of controllable growth over recent quarters was once again combined with positive client hiring in the quarter. The pace of client hiring remains below our historical averages, but we continue to see consistency in client hiring rates across most regions and industries.

Looking at wage rates and hours worked. Total hours continued to remain stable in the quarter, while overtime hours increased modestly year-over-year. Wage rates continue to increase as well, and average billing per WSE increased 3% in the quarter.

Looking at year-over-year PEO gross billings growth by region. The East Coast grew by 18%. Mountain and Southern California each grew by 10%. Northern California grew by 6%, and the Pacific Northwest declined by 1%.

Southern California represents our largest region and has improved to double-digit growth through a combination of consistent client adds and stable customer hiring. The strong East Coast performance represents the 14th consecutive quarter of double-digit growth in that region and is also driven by a combination of strong controllable growth and above-average client hiring. The Pacific Northwest region is successfully adding clients but continues to be most impacted by slower client growth, including being the only region with net negative client hiring in the quarter.

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 Q3 '24, we recognized favorable prior year liability and premium adjustments of \$4.3 million.

As a reminder, our client workers' compensation exposure is now primarily covered by our fully insured program with no retained claims risk by BBSI.

Our overall profitability continues to benefit from operating leverage. This quarter saw an increase in SG&A expense on a year-over-year basis that was expected and was driven primarily by increases in variable employee compensation and incentive pay related to stronger financial results compared to the third quarter of 2023. Year-to-date, our SG&A growth remains in line with expectations and our full year profit goals.

Moving to investment income. Our investment portfolios earned \$2.2 million in the third quarter, in line with the prior year. Our investment portfolio continues to be managed conservatively with an average quality of investment at AA and average book yield of 2.9%. The combined result of these activities was net income per diluted share of \$0.74 compared to \$0.67 per diluted share in the year-ago quarter.

Our balance sheet remains strong with \$94 million of unrestricted cash and investments at September 30 and no debt. We stayed consistent in 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 our \$75 million July 2023 repurchase program, BBSI repurchased \$8 million of shares in the third quarter at an average price of \$35.09 per share, with \$37 million now remaining available under the program at quarter end. We also paid out \$2.1 million of dividends in the quarter at our increased dividend rate of \$0.08 per share. This brings our return of capital to shareholders to \$10.1 million in the quarter and over \$28 million year-to-date.

Moving to our outlook for the full year. We had strong results in the quarter, and we are reflecting that in our updated outlook. We now expect gross billings to increase between 7% and 8% for the year versus 6% to 8% prior. We continue to expect WSEs to increase between 4% and 5% for the year. We now expect gross margin as a percent of gross billings to be between 3.03% and 3.07% versus 3% to 3.1% prior. And we continue to expect our effective annual tax rate to remain between 26% and 27%. I will now turn the call back to the operator for questions.

[Operator Instructions] The first question comes from the line of Jeff Martin from ROTH Capital Partners.

I wanted to touch on the competitive environment. A lot of your public peers are really struggling for growth in this environment and competition seems to be fairly cutthroat, just curious what you're seeing out there. And given this is your first real full year of BBSI Benefits, do you think that's helping you outpace growth relative to peers?

Yes. Good question. A couple of things, right? One is our clients are in a sweet spot, I would say, for the macro economy. Our blue, gray clients are modestly hiring. Now Anthony said it's at a pace less than the historical, but it's growth, right? I won't take growth because last year, we didn't have growth in that space. So our clients are growing, number one. Our clients are healthy. We're retaining our clients. That's key in this business, to retain your business, and we've got a very high retention rate from the products and services that we provide.

And then on the sales side, we've been saying for years that workers' comp has been competitive. That hasn't changed. And then as far as competition in the marketplace, we've had a lot of focus and attention on our sales pipeline, our sales efficiency, our sales process. We're getting more referral partners recommending business to BBSI. We're getting more prospects. We're getting more closes. With those closes, we get more worksite employees. So just in general, we're selling and servicing more, and we're doing that in a market that, in my mind, I don't think it's any more competitive, it's just always been competitive. But we've got a good focus and attention on it.

And then on the health side, it is another arrow in our quiver. It's something that we're now getting referral partners in the benefit space, we're getting clients that we wouldn't have typically seen before that are looking for a packaged product. So we've got new products that are attracting new referral partners and new products that are attracting clients. So I think we've been working on the right things, and we're putting together some consecutive quarters of positive results.

Excellent. On the benefits side, do you foresee providing additional details about the offering from a metric standpoint, from a contribution standpoint, in 2025 relative to what you're currently disclosing? And could you also touch on to what degree that could be accretive, maybe not just next year but just broadly speaking, in the mid- to longer term?

Sure, Jeff. Yes, this is Anthony. Yes, we continue to watch the disclosure side of it. Obviously, it's been fairly immaterial this first year. But as it grows, we'll continue to enhance disclosures. There's some commentary about it in our MD&A., and obviously, Kramer does give statistics in his script, but we'll continue to incorporate those more formally going forward.

In terms of the profit potential, we've said there's really only upside for us on the benefits product. So we're already covering the cost of the program. It's profitable, a little better than breakeven. So we really haven't seen earnings leverage from that, and that's really what we're expecting to start seeing in 2025 that Kramer mentioned. And that will just grow with scale. So we have our kind of foundation built both from the IT side and the operations side.

So as we continue to sell more of that benefits product, the gross margin rate on that will be, on average, a little higher than our typical gross margin rate today of around 3%. So as we continue to add those dollars and won't have to add very many incremental SG&A dollars, we should start to see some strong operating leverage that could be meaningful to the bottom line as that scales up.

Great. And then last question for me is on the pipeline side. You've done a lot over the last, say, 3 to 5 years to add additional sources of leads. Just curious if you could give us an update if there are any in particular that are currently contributing to a greater degree than some of the others.

It's broad-based. I mean we are a referral partner-friendly PEO. We treat our referral partners like clients as well. We've got a lot of respect for them and ultimately want to help them grow their book and their profitability. So our profile is really the P&C brokers, the employee benefits brokers, CPAs, things of that nature, trusted advisers, small business. And that profile has not changed. We're just getting better at bringing on more referral partners. So it's really the velocity of referral partners that we're bringing on that's making a difference.

And then the other leg of the stool is we've also started our direct efforts, right, so our SEO, SEM lead- gen technologies that we're using to bring in direct efforts, and we're seeing positive results there. So it's a multichannel approach that we're using to make sure that we got a fair amount of business that comes into the top of the sales funnel.

The next question comes from the line of Chris Moore from CJS Securities.

Nice quarter. Maybe we'll start with just gross billings growth. The guide is 7% to 8%. You did 9% in Q3. Historically, you've had more than a few double-digit gross billing years. What kind of environment would you need to consistently grow double digits again?

Yes. We talk about our controllable growth, right? So that's the clients we add in the WSEs they have and the clients we retain in WSEs. Our controllable growth is the best it's ever been, right? So that's going to be a huge piece of our growth this year is going to be on our controllable side. Then you're going to get a little wage inflation, which is going to help you grow as well. And then you're going to get your clients that are hiring, which is going to help you grow as well.

Now the client hiring, Anthony mentioned it's still below historical levels. We grow quicker when our clients hire, not by our clients giving raises. So the more employees they hire, the quicker we grow. And that has been the slowest piece in this economy. Last year, it was negative. This year, it's positive. But it's still a fraction of what it was on our historical level. So it's running like 25%, 30% of what it was historically. So realistically, that number, as far as our client hiring were to increase, would easily put us back into the double-digit sweet spot.

Perfect. Maybe just kind of on that competitive environment we're talking about. So TriNet and Insperity, perhaps your 2 closest comps, I'm going to ignore valuations today before they run crazy, TriNet was down, I think, more than 20% since this time last year, Insperity down 40%. You guys up 35% to 40%. Certainly, that well-timed split helped. But the models are different. They take more risk. But you're really subject to many of the same macro challenges. I wonder if maybe you could just kind of compare and contrast your model versus theirs.

We respect our peers, and we play in a massive space that really is underpenetrated. So when we go to market now, we're not taking business from competitors, from other PEOs. It's typically, and still, converting clients to the outsourced model for the first time, right?

I'll just speak to the strengths of our model, right? So number one, people are our product. We've got all of the tools of the PEO industry, the 401(k)s, the payrolls, all the different tools, the technology. But the differentiator for us has been and always will be our local service teams, right? If I have the option of if it's a bake-off and it's the same price and I can have a local service team plus a per se call center, I would go with the local service team every day. And our clients really gravitate to that. So that local service team is our differentiator, and that's one of the reasons why we have such high client retention, which helps us on the forward growth, right? So that's really the big thing.

We skew to the blue, gray because of our workers' comp offering and our comfortability and expertise in workers' comp. And we feel like that is, what I'll say, an underpenetrated PEO market, and we're very

comfortable in that blue, gray collar space. That's our sweet spot. We know it. We know our swim lane. We stay in it.

And then the other thing you mentioned, we've been on a journey over the last 4 years to derisk the organization. We don't take risk on workers' comp. We don't take risk on health insurance. We did this for a reason. We think it gives us predictability in profitability, predictability in cash flow, which ultimately, if we put up good consistent growth, that has good consistent earnings and cash flow, we think we'll demand a superior market multiple. So that's been our strategy. We know what we're good at, and we're executing to that.

Appreciate that. Last one for me, I think you referenced it, but you've talked about SG&A growth being half of revenue growth. That's still the target?

Yes. I mean I'd say our target really is earnings leverage, which is accomplished by growing SG&A slower than we're growing the top line. That ratio can change a little bit from year-to-year depending on that top line growth where we're at in the cycle. But the goal is to grow 10% on the top line, to grow 15% on the bottom line, so about 1.5x leverage.

And Chris, to clarify, Anthony said in his prepared remarks, so Q3 was a profitable quarter and a lot of our compensation is profit-related. So the more profit we have, the more profit share we have to pay out. And that's where you're seeing a little bit of a dip in the quarter, but on the year, we're about where we want to be.

The next question comes from the line of Vincent Colicchio from Barrington Research.

Yes, Gary. You've been at your PEO staffing business, if I remember correctly, for about a year or so. It's good to hear the progress there. Do you think you're in a place where you can consistently grow that going forward?

Yes. We've been doing the recruiting for our PEO clients now. It's really a product that, if you think of it, they've never used recruiters before. A lot of it is in the small blue collar space. They've been doing it on their own or friends of friends or friends of employees, and they've never adopted a recruiting model. So when they're typically joining us, they're doing recruiting for the first time. And we're getting good penetration into our installed base, and then we use it as a sales tactic when we're bringing on new business. So it's been working well for both.



And then every branch has goals. Every branch is talking to their clients about it. Every branch gets compensated on how many placements we're putting in. So we've got alignment through the organization in order to make sure this is successful because we think it's a really good tool for our clients.

And then are health care brokers becoming more productive as a source of referrals?

Yes. I don't want to overplay this, it's still a small fraction of our referral partners, but it's growing. And we've had more success. It's interesting, their busiest time of year is right now, and we're getting more business from them right now because they've come to understand that if they place the business with BBSI, we handle all of the administration, enrollment and it frees up their time to sell more business. So we're having better penetration this quarter in that distribution channel than we have in the prior quarters ever.

Nice quarter.

Thanks.

The next question comes from the line of Marc Riddick from Sidoti & Company.

Either in your prepared remarks or the press release, besides talking about the value-added and sort of where we are with the BBSI Benefits, I was wondering if you could talk a little bit about some of the potential new product offerings, new service offerings, things of that nature, that you might be looking at or if there is any sort of adjacencies that have sort of opened up as an opportunity to layer on with benefits.

Yes. Marc, we have a pretty well-baked product road map. And I don't want to spill the popcorn or get ahead of ourselves, but we have a pretty baked product road map. And when we get to next quarter, we're going to be talking about some new products that we're launching in '25. I don't want to spill the popcorn now, but we will be launching additional new products that are bolting into our tech platform that will be used by our clients to better service their business. And we're excited about these products that are going to go out next year, but we're going to wait a quarter until I can say it with confidence that it works because right now, it's in beta with some of our clients. But until we get through beta and launch it, I don't want to overpromise.

Okay. That's something to look forward to. That's great. And then I was wondering if you could talk a bit about the client retention trends that were, I think, referred to in prepared remarks, maybe what you're seeing as far as any potential. It seems

as though things have been pretty strong, but maybe you could talk a little bit about what those trends have looked like and maybe if you've had the opportunity to sort of see other platforms or verticals come aboard a little more aggressively than others?

Yes. Our retention continues to be above 90%. It's really our bogey. That's our target. For the 10% of the clients that run off, the lion's share of them is because they go out of business or M&A. Over half of clients that leave us are in that bucket. And that's really, call it, a success factor if they sell or if they retire or something like that. I mean that's just kind of the nature of the business.

We can say that we've seen that increase some as times got a little harder. As you think of just the economy, right, the stimulus money has run out and the businesses have to stand on their own. And some of them, I think, has been propping it up, and we're seeing a higher closure or sale right now. It's nothing that give us any pause or concern. It's just our retention is really strong in spite of that, right? So we feel really good about our retention on that metric.

And then the other pieces are we're not perfect, sometimes we lose business we don't want to lose or the clients have to go somewhere else because of certain requirements. But just in general, our teams in the field really get intertwined with the operations of our clients to the point of we are an extension of their business. And as an extension of their business, they tend to stick around with us longer because of that.

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

I just want to thank all the BBSI professionals for a great quarter. Thank everybody for the support. Appreciate it.

Thank you. Ladies and gentlemen, this concludes our call. Thank you for your participation. You may now disconnect your lines.