CBIZ (Q2 2021 Earnings)

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Corporate Speakers:

- Lori Novickis; CBIZ, Inc.; Director of Corporate Relations
- Jerry Grisko; CBIZ, Inc.; President, CEO & Director
- Ware Grove; CBIZ, Inc.; Senior VP & CFO

Participants:

- Christopher Moore; CJS Securities, Inc.; Senior Research Analyst
- Marc Riddick; Sidoti & Company, LLC; Business and Consumer Services Analyst

PRESENTATION

Operator: Good day, and welcome to the CBIZ Second Quarter 2021 Results Conference Call. (Operator Instructions)Please note, this event is being recorded. I would now like to turn the conference over to Lori Novickis, Director of Corporate Relations. Please go ahead.

Lori Novickis: Good morning, everyone, and thank you for joining us for the CBIZ Second Quarter and First Half 2021 Results Conference Call. In connection with this call, today's press release has been posted to the Investor Relations page of our website, cbiz.com. As a reminder, this call is being webcast and a link to the live webcast as well as an archived replay and transcript can also be found on our website.

Before we begin our presentation, we would like to remind you that during the call, management may discuss certain non-GAAP financial measures. Reconciliations of these measures can be found in the financial tables of today's press release and in the investor presentation on our website.

Today's conference call may also include forward-looking statements, including statements regarding our business, financial condition, results of operations, cash flows, strategies and prospects. Forward-looking statements represent only estimates on the day of this conference call and are not intended to give any assurance as to actual future results. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties. Many factors could cause future results to differ materially. A more detailed description of such factors can be found in our filings with the Securities and Exchange Commission. Please note that CBIZ assumes no obligation to update forward-looking statements.

Joining us for today's call are Jerry Grisko, President and Chief Executive Officer; and Ware Grove, Chief Financial Officer. I will now turn the call over to Jerry for his opening remarks. Jerry?

Jerry Grisko: Thank you, Lori, and good morning, everyone. With the release of our second quarter results, I'm proud to report another quarter of exceptional performance, with strong growth across nearly every major service line. But before I comment on our most recent results, I'd like to discuss the legal settlement that was announced at the end of June. The settlement related to a lawsuit pertaining to actuarial services provided 8 years ago by a former employee regarding valuation of pension plan liabilities.

This suit was unusual in a number of ways, including the complex and technical nature of both the claims and defenses by each of the parties. There was also very little legal precedent related to many of the claims that guide the jury in their deliberations. These facts created unique risks, including the claims by plaintiff could have resulted in large jury verdict of up to several hundred million dollars if the jury elected to award punitive damages.

We were in the midst of the trial when the parties reached an agreement. Given the complexity of the facts, the risk of substantial loss and the uncertainty inherent in jury trials, and this one, in particular, we believe that settling the case for the amount previously disclosed was the most responsible decision for the company and our shareholders. Moreover, this settlement does not materially increase our debt and our steady cash flow, strong balance sheet and access to capital allows us to continue to make investments to grow our business, complete strategic acquisitions, buy back stock and fully fund our operations.

It's also worth noting that this is the first legal sentiment in our 25-year history relating to an errors and omissions claim that substantially exceeded the limits of our insurance coverage. And while we do not disclose the limits of our insurance coverages, we have considerably increased the amount of our coverage for E&O claims over the past 8 years. It's also important to view the impact of the settlement in context as a nonrecurring events and not allow it to overshadow the exceptional performance and results that we are seeing in our business.

With that, I want to turn to our performance for the first half of 2021. I am pleased to report that through the first 6 months of this year, we are seeing improved performance from nearly every major service line, resulting in the strongest year-to-date organic revenue growth that we've experienced in over a decade.

Within our Financial Services group, we continue to experience very strong demand for our core accounting and tax services. We are also seeing a return of demand for our more project-oriented advisory services, particularly those related to helping our clients with acquisitions and divestitures.

In addition, over the last several years, we've made substantial investments in tools and systems that assist our leaders to improve revenue and profitability and accelerate the time it takes to collect accounts receivables. Our most recent results within our Financial Services division reflect the outcome of those investments. Our government health care consulting business has -- also continues to enjoy solid growth. Although that business has been somewhat impacted by delays, as some states are holding off on certain work until they are more fully reopened and resume more normal operations. Even with these potential delays, the work is required and will be completed at some time in the future, but we are monitoring how timing may impact the rate of growth for this business through the remainder of the year.

Turning to our benefits and insurance group. The trend continues to follow what we saw in the second half of last year with high demand in our Employee Benefits, Property & Casualty and Retirement plan advisory businesses. Within our property and casualty business, our commercial side of the business is fueling very strong growth. While we are also seeing steady improvement on the program side, throughout last year, we talked about some areas of our P&C program business being more impacted by the COVID-19 pandemic than others. For example, the reduction in leisure travel and related spending, we experienced early in the pandemic impacted parts of that business like adventure sports. These areas are starting to come back as these industries continue to recover.

In our payroll business, last year, specifically, during the second quarter, we saw a drop in the number of pays as our clients reduced their workforce. While this trend eventually leveled off later in 2020, we are now seeing the number of pays trend upwards again, which points to recovery among our clients and creates additional opportunities for this business. While the number of pays has not returned to pre-pandemic levels, there are reasons for optimism, given the current trends.

Client retention within our benefits and insurance business remains strong. Similar to our financial services business, we are also experiencing increasing demand for many of our project-based services. For example, the improving economy is driving new sales and growth within our executive recruitment and compensation consulting practices as many businesses look to add talent and fill critical roles.

One additional area I want to highlight is our investment in producers. Our ability to attract, retain and develop our producers is essential to accelerate organic growth, and I am pleased to report that we continue to make good progress in this area. The new producers we brought on in recent years in our employee benefits business continue to outperform our projections, and we have also added to the number of producers in our retirement plan services and our property and casualty businesses. We have also added to the capacity within our recruiting team to be more targeted in our outreach and accelerate our efforts to secure talent.

With that, I will turn it over to Ware for his comments.

Ware Grove: Thank you, Jerry, and good morning, everyone. I want to take a few minutes to go over the highlights of the numbers we released this morning and talk about what we expect for the full year. The results we reported for the second quarter and first half include the impact of 2 major nonrecurring items. As required, the reported GAAP numbers fully reflect the impact of those items. But in order to provide greater clarity on the results from continuing operations, we have also presented adjusted numbers to exclude the impact of those items.

Jerry talked about the settlement we reached on the UPMC matter and the second quarter charge of $30.5 million that we reported, net of insurance coverage. In addition, during the second quarter, we divested a small noncore wholesale insurance operation, and we recorded a gain of $6.4 million as a result of that transaction. The earnings release includes a reconciliation of those nonrecurring items from the GAAP presentation to arrive at adjusted earnings per share numbers. Of course, we can answer any further questions you may have on these 2 nonrecurring items during the Q&A period following our comments. But without going into further detail, I will focus my comments here on the adjusted numbers.

We think the adjusted numbers are most useful to you as you assess the health and performance of our ongoing business. We are very pleased to report strong growth in total revenue of 17.6% in the second quarter and total revenue growth of 12.6% for the 6 months ended June 30. Revenue growth is being driven by a combination of strong, same unit growth of 10.5% in the second quarter and same unit growth of 6.8% for the 6 months.

The acquisitions we made last year and through the first half of this year, have contributed 7.1% to growth in the second quarter and contributed 5.9% to revenue growth in the 6 months.

The business service lines that were more COVID impacted and reflected declines in 2020 are now recovering and have recorded growth through the first half this year. As we finished 2020, I commented that those businesses represented about 16% of total revenue, had collectively declined 12.8% for the full year 2020 compared with 2019. Collectively, these businesses recorded growth of 6.7% for the first half this year, which is in line with consolidated first half same unit revenue growth. As evidenced by this very strong first half, 6.8% same unit consolidated revenue growth, the core businesses that recorded growth last year in 2020 are continuing to perform very well the first half this year.

Acquisitions continue to be an important component of our growth strategy. As a reminder, we announced 7 acquisitions last year in 2020 that are expected to contribute $45 million of annualized revenue. Through the first 6 months this year, we made 4 additional acquisitions that are expected to contribute $42 million of annualized revenue. The newly acquired businesses are performing very well, and we continue to evaluate a number of potential acquisitions with an active pipeline under review.

Total revenue in our Financial Services group increased by 21.1% in the second quarter, with same unit revenue up by 13.3% compared with a year ago. For the 6 months, total revenue grew by 14.0%, with same unit revenue up by 8.5%.

Turning to the benefits and insurance group. In the second quarter, total revenue grew by 11.7%, with same unit revenue up by 5.3%. For the 6 months, total revenue within benefits and insurance grew by 10.6%, with same unit revenue up by 3.4%. The revenue growth recorded this year has been fueled by the tools and investments we have made in recent years. There have been significant investments to build stronger producer teams. We have developed tools to optimize profitability of client engagements within financial services. Plus our focus on digital marketing efforts is resulting in a stronger pipeline of potential new business. And importantly, we have focused resources to boost acquisition activity. All of these initiatives are gaining traction and represent a concerted effort to enhance revenue growth while achieving operating leverage to improve margin over time.

Eliminating the 2 nonrecurring items, pretax income margin was 12.7% in the second quarter, up 90 basis points compared with 11.8% a year ago. For the 6 months, pretax income margin was 17.5%, up 230 basis points compared with 15.2% a year ago.

With early seasonal tax work this year compared with last year, we experienced tailwinds in the first half this year. The second half of the year is seasonally more heavily reliant on project work. The business is performing very well, but second half revenue growth may be less certain. A lower cost structure in the first half this year continues to reflect lessons learned from our experience with the pandemic and that is reflected in higher first half margins.

As I commented at the end of the first quarter, we are selectively restoring discretionary items that may present some headwinds and margin pressure in the second half of the year. As we begin to get back in front of clients and prospects, related T&E expense may begin to increase from current extraordinarily low levels. With marketing costs after suspending all programs a year ago, we elected to conduct a second quarter media campaign this year, and we are considering a second campaign later in the year.

Within our benefits costs, health care costs have continued to be lower than expected through the first half this year. Health care benefit costs are not highly controllable in the short run, and we are expecting second half headwinds as medical visits and elective procedures are beginning to resume in a more normal level of activity after seeing low levels in 2020 that have continued through the first half of 2021.

Eliminating the impact of nonrecurring items, we are pleased to report adjusted earnings per share of $0.50 for second quarter, up 28.2% compared with $0.39 compared a year ago. For the 6 months, adjusted earnings per share was $1.43, up 36.2% compared with $1.05 reported a year ago. Cash flow and liquidity continue to be strong. At June 30 this year, there was $163.3 million outstanding on our $400 million credit facility. This results in a leverage measure of 1.0x EBITDA at June 30 with approximately $230 million of unused capacity. After giving effect to the upcoming payment for the UPMC settlement amount, leverage will increase to approximately 1.25x EBITDA with slightly over $200 million of remaining unused capacity.

During the first 6 months this year, we closed 4 new acquisitions and used $51.2 million for acquisitions, including earn-out payments for acquisitions closed in previous years.

We also actively repurchased shares in the open market, and we used $63.4 million to repurchase approximately 2 million shares through June 30.

With respect to future earn-out payment obligations, we estimate approximately $5.5 million over the balance of this year, approximately $20.8 million in 2022, approximately $14.4 million the following year in 2023 and $17.7 million in 2024 with another approximately $800,000 in 2025. The strong cash flow and a strong balance sheet, we have ample flexibility to strategically deploy capital to actively pursue acquisitions and conduct share repurchases.

Looking back 18 months during this challenging time period from January of 2020 through today or through June 30 of this year, we have closed 11 acquisitions using approximately $140 million of cash for acquisition purposes. Over the same 18-month time period, we've also used approximately $120 million to repurchase 4.3 million shares, which is nearly 8% of shares outstanding.

Capital spending. The first 6 months this year was $3.3 million with $2.1 million in the second quarter. This is lower than in recent years and reflects the intentional deferral of spending for facility-related decisions in 2020. In a normal year, we expect capital spending of approximately $12 million. But for 2021, we expect capital spending will come in at approximately $8 million. Day sales outstanding on receivables continue to reflect improvement. At June 30 this year, day sales outstanding stood at 84 days compared with 87 days at June 30 a year ago.

With a diverse set of clients and no concentration in industries such as hospitality, entertainment or travel that may have higher risk attributes, our receivables have continued to perform well. You may recall, we recorded a $2 million provision for bad debt in the first quarter a year ago, with bad debt expense for the first half a year ago at 62 basis points of revenue. Bad debt expense for the first 6 months this year is only 5 basis points.

Adjusted EBITDA for the first 6 months this year was $116.2 million or 20.1% of revenue. This represents a 25% increase over $92.9 million in the first 6 months a year ago. For the first 6 months this year, the effective tax rate was 24.01%. Looking to the full year of 2021, there are a number of unpredictable factors that can impact the effective tax rate, either up or down, and we continue to expect a full year effective tax rate of approximately 25%. With the share repurchase activity to date through the first half, we expect full year 2021 weighted average fully diluted share count to be approximately 54 million shares. As a result of first half acquisition activity, we are raising our full year revenue guidance, and we now expect total revenue growth in a range of 10% to 12% over the prior year, and that this is up from 8% to 10% growth previously.

First half growth in adjusted earnings per share reflects the fact that the business is very healthy. As we set full year expectations for adjusted earnings per share, we are weighing the uncertain potential to incur higher benefit health care costs in the second half, coupled with our desire to selectively restore some level of marketing or other client-related activities designed to enhance revenue growth over time. For those reasons, the level of margin improvement achieved in the first half this year is likely not sustainable for the balance of the year.

We also need to be prudently cognizant of the continuing potential volatility and uncertainty in the environment. At this point, we expect full year 2021 adjusted earnings per share to grow near the higher end of a range of 12% to 15% over the $1.42 EPS reported for 2020. Of course, we will have an opportunity to revisit this guidance at the end of the third quarter.

So with these comments, I will conclude, and I'll turn it back over to Jerry.

Jerry Grisko: Thank you, Ware. I'd like to touch on our M&A activity before we turn it over to Q&A. As I discussed last quarter, we started this year with the strongest M&A pipeline we've seen in our recent history. M&A continues to be a key component of CBIZ's growth strategy and will remain a top priority for us in 2021 and beyond, especially as we see increasing interest in CBIZ as a potential partner.

Our performance over the last year on the backdrop of the pandemic demonstrates the value and stability of our business model. We also continue to emphasize our unique position in the market, given the breadth and depth of our expertise and our services. Moreover, our steady cash flow, strong balance sheet and access to capital allows us to continue to make investments in the business that many of our competitors simply cannot fund. We know that these messages resonate with firms in each of our various businesses, and we are eager to explore these opportunities.

So far this year, we've completed 4 acquisitions with 3 of those coming in the second quarter. During the second quarter, we completed one acquisition to support our retirement plan services business and another, the acquisition of Berntson Porter, a core accounting firm located in the Pacific Northwest, which I discussed in our last earnings call.

Most recently, at the beginning of June, we completed the acquisition of Optumas, a firm based in Scottsdale, Arizona that specializes in providing actuarial and consulting services to government health care agencies to assist in the administration of Medicaid programs. Optumas has a long history of partnering with CBIZ, and this acquisition will allow us to expand our relationship with existing clients and enable opportunities to scale these services through our national infrastructure.

With this, I will turn it over for Q&A.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) The first question today will come from Chris Moore with CJS Securities.

Christopher Moore: So yes, same-store growth was up, I think, 6.8% in the first half. I'm just trying to get a better sense in terms of how pricing increases works in that. Can you maybe talk a little bit the mix between price increases and increased volume from cross selling, share gains, et cetera?

Ware Grove: Hi Chris, this is Ware. We did get some higher yield and some price increases aligned with some of the efforts we talked about to increase or improve efficiencies and the engagement on the financial services side. And then, of course, market conditions on the property and casualty insurance side are -- it's a strong market. So there are some increases there as well. We typically would say, and I don't think this is anything unusual for the first half this year, about half of the increase is due to volume and just increased activity, whereas about half of it is due to pricing increases. I think that's the case here for the first half this year.

Christopher Moore: How much revenue did the divested wholesale insurance business? How much was that generating on a kind of trailing 12-month basis?

Ware Grove: Yes, Chris. This is Ware again, slightly less than $3 million. It's actually a pretty small non-core piece of our business.

Christopher Moore: And just last one for me. On the University of Pittsburgh settlement. So I know there's one other active case out there Zotec Partners. I'm wondering if maybe you could kind of compare and contrast that to the University of Pittsburgh. For example, you talked about no real legal precedent, which was a big risk factor on University of Pittsburgh, very complicated. Kind of any thoughts on the Zotec side.

Jerry Grisko: Chris, this is Jerry. Yes, I'll provide a couple of comments on that. What I would say are very different facts and circumstances relating to UPMC compared to Zotec. The UPMC claim was at its core an errors and omissions claim relating to work that we did, very complex actuarial work we did on a pension plan. The Zotec case actually is a claim by the purchaser of, if you recall, our medical billing business some years ago. And again, very different claims, very different facts and circumstances, and we believe we have, as we've announced, strong defenses to that claim, and we will vigorously pursue those defenses.

Operator: Next question will come from Marc Riddick with Sidoti & Company.

Marc Riddick: So I was wondering if you could discuss a little bit around the announcements around the new headquarters and maybe some of the things that are going into to that and from a time frame and sort of how that might flow. I know that the pressures talked about next September. But I was wondering if you could sort of give a little bit of color around that and what we can expect there?

Jerry Grisko: So this is something we've been working on for a while. We've been in our existing facilities for about 18 years. And candidly, just the way that we work and the way that our workforce comes to work and the way we collaborate with each other has changed over that period of time. And while we're very happy with where we are and enjoyed certainly the time that we spent here, we were really excited about the opportunity to enter and to be an anchor tenant at a brand new facility, state of the art, we are actually at the table helping to design that facility as the anchor tenant, and it will allow us to really prepare for the next 20 years and what that work -- the way our workforce comes to the office, the way that we collaborate with each other, the way that we collaborate with our clients, including state of the art technology, workflow in the design and the workspaces that are within that facility. So kind of across the board, really just a great opportunity for us to do that. You probably also saw that we received considerable support from the state of Ohio and from the local governments, and we're really appreciative of that partnership as well. So kind of everything came together to allow us to do this, and we're excited about what that means for us going forward.

Marc Riddick: And then the timing, I guess, is more -- so we're looking at the fall of next year. If I remember correctly, are we sort of targeting from a seasonal standpoint, it certainly doesn't -- it would be after tax season, but I was wondering if we should think about any potential disruptions or anything along on those lines to take into consideration for next year?

Jerry Grisko: Yes, Mark, the timing -- you're right. It's in the fall of next year. We don't have exact kind of move in date, but it will be the fall of next year. The only kind of potential disruption, and I think it's pretty insignificant, particularly in light of what we've learned over the past year is that there will be some gap between the time that we leave this space, our existing space and the time that the next space will be available. But we're working through that now in the combination of Flex base, which is available in our local market and some continued remote work will allow us to bridge that gap. So really no bearing material bearing on the business in the move that we can see right now.

Marc Riddick: And then I was wondering if you could spend a little time talking about -- you touched on this in your prepared commentary, but I was wondering if you could expand a little bit on maybe some of the progress you're making because certainly from the numbers, it certainly seems as though it's positive. But are some of the benefits that you're getting from your marketing programs, whether it be the -- sort of the digital outreach that was ramped up during the pandemic, and maybe we're seeing the benefit of some of that as well as further progress that's made with some of those new contacts? And then maybe you could also talk a bit about how we should think about or how you feel your local market share has progressed during the course of the challenges of the pandemic?

Jerry Grisko: CBIZ like many businesses. We learned a lot over the past 16 months, right? And one of the things I think that has been most beneficial to us is our ability to provide really our value, our unique value proposition, which is breadth of services and depth of expertise in a way that, candidly, we haven't experienced before COVID. So an example of that is when we sit with a client and our clients have multidisciplinary needs, pre-pandemic, oftentimes, we would have to fly people in from around the country, the experts, the subject matter experts to sit with our clients and sit with our team to solve whatever challenges or opportunities the client was working on. Today, through the virtual tools that we've all learned to adopt, that's much easier to do.

Our clients are far more receptive to that, and we're far more comfortable providing services in that way. As far as digital is concerned, we reached out to our clients, at the outset of the pandemic with, as we talked about in earlier calls, very frequent webinar programs, trying to anticipate what was front of mind for them, what their greatest needs were in putting programs in front of them. And that effort has continued. We've also learned to follow-up with our clients using those digital channels and digital outreach in ways during that pandemic, and that effort has continued as well.

And as a result of that, the top of the funnel for our sales pipeline has not been this full in many, many, many years. So not only have we learned to identify opportunities and put them in the top of the funnel, but also to convert those opportunities to sales in a hybrid approach, some face-to-face, but certainly some more virtual. So -- and we're learning to close those opportunities as well. So we've learned a lot. We continue to learn, but the future looks very promising in all those regards.

Operator: At this time, there are no further questions in the question queue. This will conclude today's question-and-answer session, and I would like to turn the conference back over to Jerry Grisko for any closing remarks.

Jerry Grisko: Thank you, Sean. Before I conclude the call today, I want to put our performance for the first half of this year in the context of our business model and what we believe these results mean for the rest of the year and beyond.

Over the last several quarters, I've emphasized the fundamental attributes of our business model, including the essential and recurring nature of our services, our high level of client retention year-over-year, the diversity of our client base in terms of size and industry and our broad geographic footprint. As we've demonstrated over the last 16 months, these attributes allow us to perform well even in uncertain economic conditions. Moreover, the breadth and depth of our services puts us in a unique position to be responsive to our clients' needs, especially when they require a coordinated multidisciplinary approach.

I've talked about the importance of our model because of the strength and stability it offers in both good and less favorable economic conditions. The extraordinary results we reported today are a testament to this model, but also demonstrate the potential of our business moving forward. For the first half of 2021, nearly all of our service lines are growing, many at the rate we have not experienced in years. In these results, we are seeing the return on our long-term investments we've made in our people, tools and systems.

We're also seeing the value we bring to our clients in both new ways, but also in the services and solutions they rely on year-over-year. And of course, our team continues to be the driving force behind these results. The energy and commitment of our team and their willingness to go above and beyond for our clients and each other is evident in our performance. I'm incredibly proud of what we've accomplished in the first half and even more excited about what is possible as we look ahead.

Based on our strong performance year-to-date, we increased our revenue guidance today, and we are guiding adjusted EPS growth to the high end of the 12% to 15% range that we previously announced. For the reasons Ware outlined earlier, we are not yet prepared to increase our adjusted EPS guidance, but remain optimistic, given the momentum in our business, and we look forward to revisiting this at the end of the third quarter.

I want to close by thanking our analysts and our investors, as we always do for your continued support. And I'd also like to take this opportunity to invite our analysts and shareholders to participate in our virtual investor conference to be held in September. That will include deeper dives into our business, operations and culture, in addition to Q&A with Ware and I and some of our business leaders. You'll be receiving an invitation and more information in the coming weeks. Thank you for your time, and have a great day.

Operator: The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.