Corporate Speakers:
- Lori Novickis; CBIZ; Director of Corporate Relations
- Jerry Grisko; CBIZ; President, Chief Executive Officer
- Ware Grove; CBIZ; Chief Financial Officer

Participants:
- Christopher Moore; CJS Securities; Analyst
- Andrew Nicholas; William Blair; Analyst
- Marc Riddick; Sidoti; Analyst

PRESENTATION

Operator^ Good morning. And welcome to the CBIZ's Third Quarter 2023 Conference Call. (Operator Instructions)

Please note that this event is being recorded today.

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's Third Quarter and 9 Months 2023 Results conference call.

In connection with this call, today's press release and investor presentation have 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 can be found on our website. An archived replay and transcript will also be made available after the call.

Before we begin, 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 investor presentation.

Today's call may also include forward-looking statements regarding our business, financial condition, results of operations, cash flows, strategies, and prospects.

Forward-looking statements represent only estimates on the date of this call and are not intended to give any further assurance of 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.

And CBIZ assumes no obligation to update these statements.

A more detailed description of such factors can be found in the filings with the Securities and Exchange Commission.

Joining us for today's call are Jerry Grisko, President and Chief Executive Officer; and Ware Grove, Chief Financial Officer.

Jerry?

Jerry Grisko Good morning. And thank you for joining us for today's call.

We're pleased to share our third quarter performance and to discuss our outlook for the remainder of the year. For the third quarter, our businesses performed as expected and we experienced strong organic growth over the same period last year. The same goes for our year-to-date results as we successfully built on the positive momentum demonstrated earlier in the year. Encouragingly, we continue to see nice growth across all major service lines and demand for those services remain strong.

I do want to take this opportunity to follow up on 2 items that we mentioned during our earnings call for the second quarter. The first was unanticipated contract delays in our Government Health Care consulting business and the second being the extension of tax filing deadlines in California, which is a major market for CBIZ.

For the third quarter, our Government Health Care consulting business rebounded and we benefited from the launch of a number of new projects and the addition of new business that enabled us to achieve our expected growth targets. For the California market, as expected, much of the work that was delayed in the second quarter was completed in the third quarter. California also ended up extending the tax filing deadline again and we expect to see some of this work shift into the fourth quarter as well. Ware will go into more detail during his remarks in a few minutes.

Now turning to the performance of our two primary practice groups.

Our Financial Services division continued to experience strong demand for our core accounting and tax services and our more project-based advisory services. We've also been able to maintain our pricing initiatives and are seeing the impact of those efforts in our results. Within our Advisory business, we experienced growth across nearly all of our major service lines due to the healthy demand for many of our services including transaction services, risk advisory services, and valuations.
In the Transaction Advisory space, a good portion of this demand is being fueled by an increase in the volume of transactions that we're seeing albeit smaller deals. We're also pleased to see some signs that the IPO market is returning which benefits the services we provide to help businesses prepare to go public.

Within our Benefits and Insurance business, we continue to achieve growth across all major service lines in Q3.

For our Employee Benefits and our Property & Casualty businesses, increased service revenue from new production and strong client retention are among the factors contributing to our growth. Our producer count is also up for both of these service lines compared to last year, as we see traction from investments that we made in our internal recruiting team and external agencies to grow our pipeline of new producers. For our Payroll business, higher interest rates on client deposits, continued strong demand for our upmarket payroll platform, and continued success with our pricing initiatives have all contributed to our growth.

The growth in our Retirement and Investment services business is coming largely from a continued uptick in project work for our actuarial team. Based on the performance throughout the third quarter, I'm pleased to reaffirm our revenue and adjusted fully diluted earnings per share guidance for the full-year that we announced at our investor call for the second quarter.

With this, I will turn it over to Ware Grove, our Chief Financial Officer to provide additional information on our financial performance for the third quarter and year-to-date.

Ware?  Ware Grove: Thank you, Jerry. And good morning, everyone.

Let me take a few minutes to talk about the key highlights of the third quarter and the year-to-date numbers we released this morning.

Let me get started by saying that in our second quarter conference call earlier this year, as Jerry commented, we outlined 2 areas that disproportionately impacted results in the second quarter. First, the IRS extensions for tax filing deadlines this year in California impacted first half and second quarter results. The 6-month tax filing extensions granted by the IRS earlier this year for the state of California has shifted some of the normal first half work into the third and fourth quarters this year.

And then secondly, the delays we encountered in several engagements during the first half this year within our Government Health Care consulting business impacted first half and second quarter results.

The delays in engagement start dates that were encountered in the first half this year have largely resolved. A number of significant new projects are now on stream and are requiring active work. As a result, we recorded stronger revenue growth within this
business and this contributed to stronger third quarter results. Aside from the occasional delay that we encountered, work within this business is characteristically very steady and we expect this will continue into the fourth quarter and into 2024. Both these issues caused what was a temporary impact to results in the second quarter.

Looking at 9 months results, with total revenue growth of 13.1% and adjusted earnings per share up 15.6% over last year, we are performing in line with our expectations. Both Financial Services and Benefits and Insurance are performing well.

Total revenue in the third quarter increased by $47.3 million, up 13% over the third quarter a year ago. Same-unit revenue was up by 8.3%, with acquisitions contributing 4.7% to growth compared with last year. For the 9 months this year, total revenue grew by $146.7 million, up 13.1% compared with last year. Same-unit revenue growth for the 9 months was up 7.5%, with acquisitions contributing 5.6% to revenue growth for the 9 months this year compared with last year.

Within Financial Services, for the third quarter, total revenue grew by $38.4 million or up by 14.8% with same-unit revenue for the third quarter up 8.4%, with strong revenue growth recorded in all lines of service, including core tax and accounting, advisory services and the government health care consulting services.

For the 9 months, total revenue within Financial Services grew by $124.3 million, up 15.4% and same-unit revenue for the 9 months was up 7.7%. Within Benefits and Insurance, for the third quarter, same-unit revenue grew by $7.5 million, up 8.2%. And for the 9 months, same unit revenue grew by 7.1%. Every major line of service within our Benefits and Insurance group recorded revenue growth for both third quarter and for the 9 months. We continue to see strong client retention and strong new client production.

The investments we have made to hire new business producers in recent years has gained traction, and we are continuing to make investments in hiring additional producers to further enhance growth potential.

On February 1, this year, we acquired Indianapolis-based Somerset CPAs and Advisors with estimated annual revenue of approximately $55 million. There are transaction closing costs plus one-time integration-related expenses associated with this transaction. In a similar manner to reporting New York-based Marks Paneth acquisition-related costs last year, we are reporting an adjustment to eliminate Somerset acquisition-related costs from GAAP-reported results this year to report adjusted results. We are extremely pleased to have the Somerset team on board this year. Both Somerset and Marks Paneth are performing in line with our expectations.

In addition to these acquisition-related expenses, we recorded a gain of $1.5 million related to the sale of a technology asset in our Financial Services practice group this year.

Last year, we recorded a gain of $2.4 million related to the sale of a book of business within our Property & Casualty insurance line of service. These gains were reported as
other income and they represented approximately $0.02 per share for 2023 and approximately $0.03 per share for 2022 for both the third quarter and the 9 months.

With a view towards presenting meaningful comparable information, eliminating the impact of these gains, and eliminating the acquisition-related expenses, adjusted earnings per share for the third quarter this year was $0.66, up 29.4% compared with $0.51 a year ago. For the 9 months, adjusted earnings per share is $2.67, up 15.6% this year compared with $2.31 last year. Adjusted EBITDA, considering these same adjustments, was $229.2 million for the 9 months this year, up 17.9% over $194.5 million last year.

A table reconciling reported GAAP numbers to these adjusted earnings per share and adjusted EBITDA numbers is included in the earnings release issued this morning.

We have previously talked about the level of health care and benefits, travel and entertainment expenses, and marketing expenses that are normalizing to higher levels. As we continue to restore and expand outreach to clients and prospects, by design, these expenses are trending higher than last year, and we have also restarted several media campaigns in our marketing programs this year. You may have seen our TV spots positioned on CNBC, PGA golf events, and in other spots. For the first 9 months this year, collectively, these expenses represented a 40 basis point headwind to margin on pre-tax income compared with last year.

An important takeaway here is that we project that these expenses will settle in approximately 100 basis points lower than pre-pandemic levels. But this year, the year-over-year comparisons present a headwind.

You can also see that interest expense creates a headwind this year. For the 9 months ended September 30, increased interest expense increased as a percent of revenue by approximately 70 basis points. For the quarter, we reported an increase in interest expense of $3.5 million with an earnings per share impact of approximately $0.05 per share. And for the 9 months, we reported an increase in interest expense of $9.8 million with an earnings per share impact of approximately $0.14 per share. As always, details of the GAAP accounting for gains and losses in our non-qualified deferred compensation plan are outlined in the release.

As you look at both gross margin and operating income comparisons, because we are comparing a period in 2022 with capital market losses compared with capital markets gains this year, there is a significant impact to the GAAP reported numbers.

Now as a reminder, pre-tax income margin is not impacted by this accounting. We will continue to say that it is our long-term goal to achieve pre-tax margin improvement of 20 basis points to 50 basis points per year. In any given year, margin improvement may be either higher or lower for a number of reasons. But over time, our results have been at the higher end of this range. Considering the significant margin headwinds that we are encountering this year; however, pre-tax margin may be relatively flat compared with the prior year.
Turning to cash flow and the balance sheet.

On September 30 this year, the balance outstanding on the $600 million unsecured facility was approximately $395 million, with about $195 million of unused capacity. With leverage of approximately 1.8x adjusted EBITDA, this provides plenty of capacity to continue strategic acquisitions, and it provides the flexibility to continue with share repurchases. In the first 9 months of this year, including the Somerset acquisition, we completed a total of 5 acquisitions. We used approximately $102 million for those acquisitions, including earn-out payments on previously closed transactions.

For earn-out payments, we expect to use approximately $7.3 million over the remainder of this year and approximately $58 million in 2024, $36 million in 2025, and $10.6 million in 2026 for these estimated earn-out payments.

Deploying capital for strategic acquisition purposes continues to be our highest priority.

Since the end of 2019, we have closed 20 transactions, and we have deployed approximately $383 million of capital for acquisition purposes, including the earn-out payments over that period of time.

Beyond using capital for acquisitions, we have the flexibility to use capital for share repurchases. Through September 30 this year, we have repurchased approximately 1.15 million shares of our common stock in the open market at a cost of approximately $58 million. Through October 25, we have repurchased approximately 1.24 million shares at a cost of approximately $62.5 million.

To recap repurchase activity in recent years since the end of 2019, we have repurchased approximately 9.3 million shares, and that represents slightly more than 16% of the shares outstanding compared to the end of 2019. Approximately $335 million of capital has been used towards this open market repurchase activity over that period of time.

Days sales outstanding on September 30 this year was 96 days compared with 93 days a year ago. Bad debt expense for the first 9 months was 8 basis points of revenue compared to 12 basis points a year ago.

Depreciation and amortization expense for the third quarter was $9.1 million compared with $8.2 million last year. Year-to-date, depreciation and amortization is $27 million compared with $24.7 million last year.

For the full-year, we expect depreciation and amortization at approximately $36 million this year compared with approximately $33 million last year. Now for those of you who want to highlight the amortization expense, which is primarily driven by acquisition activity, for the 9 months, amortization expense was $17.8 million.
And for the full-year, we project it may be approximately $24 million. Capital spending for the third quarter was $7.3 million and was $19 million for the 9 months. Greater spending is occurring this year for tenant improvements and furniture related to several significant office moves, including the upcoming November 1 move to our new headquarters facilities.

As a reminder, we are a major tenant with a long-term lease in our new headquarters building. We are not an owner of the building. For the full-year this year, we're expecting capital spending in a range of $20 million to $25 million.

That is driven by a number of facilities moves this year within our network of 127 office locations. Capital spending normally runs within a $10 million to $12 million annual range, and we expect spending closer to that lower level in the years ahead. The effective tax rate for the 9 months this year was 27.9%, up from 26% a year ago. The impact of the increased tax rate for the 9 months was approximately $0.07 per share. With a forecasted full-year effective rate of 28%, we expect the full-year impact at approximately $0.08 per share this year.

It is important to understand the increased effective tax rate in 2023 is a headwind that is unique to this year compared to 2022.

In future years, we expect the effective tax rate to be relatively leveled at approximately 28%, and we project no further year-over-year tax-related headwinds beyond this year. The recurring and essential nature of many of our services provide stability through economic cycles. At this point, as we look at employment-driven metrics within our Benefits and in our Payroll businesses, we are seeing continued signs of steady employment within our clients. Economic uncertainty continues, however, and if we experience pressure on our revenue growth, there are a number of variable items in our cost structure where we can take measures to mitigate the impact. The tools and systems we have put in place in recent years have enabled us to increase pricing and keep pace with underlying cost pressures, leverage costs and protect margins. The investments in adding new business producers focused within our Benefits and Insurance group have gained traction.

Coupled with solid client retention, this is driving strong revenue growth.

Now before I turn it back to Jerry, I want to provide you with our thoughts on full-year guidance. As we look ahead, several factors come to mind as we look at the balance of the year compared with last year. The interest expense and higher tax rate headwinds that impacted 9 months results by $0.21 per share will persist into the fourth quarter. Despite these headwinds, with 15.6% growth in adjusted earnings per share for the 9 months, the business is performing very well. Fourth quarter results, however, are typically more dependent upon project work that is more difficult to project.

Also, with the addition of both Somerset and Marks Paneth within our core tax and accounting financial services group, the seasonal nature of these businesses may amplify
the volatility between stronger first half and seasonally weaker second half results. The business is performing in line with expectations, and we are very pleased with the results for the 9 months.

So to recap full-year guidance, we will say the following: we expect total revenue to increase within a range of 10% to 12% for the year. On an adjusted basis, we expect 2023 adjusted earnings per share to increase within a range of 11% to 13% over the adjusted earnings per share of $2.13 that was reported in 2022. GAAP reported earnings per share is expected to increase within a range of 15% to 17% over the $2.01 reported in 2022. The effective tax rate for the full-year of 2023 is expected at approximately 28%. This rate could be impacted either up or down by a number of unpredictable factors.

And lastly, the fully diluted weighted average share count is expected within a range of 50.5 million to 51 million shares for the full-year of 2023. So with these comments, I'll conclude, and I'll turn it back over to Jerry.

Jerry Grisko^ Thank you, Ware. Before we move to Q&A, I'd like to provide a brief update on our M&A results for the year. So far, in 2023, we've completed three acquisitions and two smaller tuck-in acquisitions. I'm pleased to report that we're making steady progress with the integration of these acquisitions and remain encouraged by their performance and contributions to date. On our more recent earnings call, we talked about the impact of private equity on M&A within the traditional accounting and tax industry.

We're actually seeing activity from private equity in the space appear to wane in recent weeks as some potential deals have fallen through or been put on hold. We continue to monitor this trend and the opportunities that it may provide in our own M&A efforts. In the meantime, our M&A pipeline remains healthy and active, and we have the capacity to pursue other opportunities.

With that, we'll turn it over to Q&A.

**QUESTIONS AND ANSWERS**

Operator^ (Operator Instructions) And our first question here will come from Chris Moore with CJS Securities.

Christopher Moore^ Thanks for taking a couple of questions. So pricing obviously has been more dynamic in 2022. Can you maybe just talk a little bit more about pricing through the first 9 or 10 months of '23? Is that looking more normal and kind of what that suggests for '24?

Jerry Grisko^ Yes. Chris, I think it's too early to really think about or talk about or predict '24. But so far for '23, we've been very pleased with our ability to continue to get pricing. And as we've talked about in a number of calls, we have built processes, systems, reporting, training around -- all around pricing throughout our core accounting offices and business, and we're pleased with the outcomes that we're getting there.
Christopher Moore^ SG&A looks much lower year-over-year sequentially, even after adjusting for the deferred comp. Why was that? And how should we look at that moving forward?

Ware Grove^ Yes, Chris, I think it would probably see some volatility quarter-to-quarter just depending on spend on legal matters and things like that, that may spike from time to time. But generally speaking, if you look at the year-to-date number, we should be leveraging G&A, some modest amount each year, maybe 10 basis points or better. And I think over time, that's what we see.

Christopher Moore^ And maybe the last one for me is just B&I gross margin continues to be strong at 20.6% in Q3. Is a 20% annual gross margin at some point possible for this business and what would it take?

Ware Grove^ I'm sorry, Chris. Were you asking about B&I? The --

Christopher Moore^ Yes, Benefits and Insurance. Yes, I'm sorry. The gross margin there was very solid, 20.6% in Q3, and I'm just -- it's usually lower in Q4. But from an annual perspective, trying to figure out if a 20% threshold on gross margin there is possible and kind of what it would take to get there.

Ware Grove^ Yes. We're not going to identify any particular ceiling or threshold, and we're going to continue to strive to get more scale and leverage in each and every business. We do that through a variety of ways. So in both B&I and in Financial Services, we should see a continued -- just like I commented on G&A, we should see a continued leverage, maybe not a steady leverage each and every year because of periodic investments. But we'll just recap that by saying in total, we should expect and we expect 20 basis points to 50 basis points a year, and it comes from multiple sources.

Operator^ (Operator Instructions) Our next question will come from Andrew Nicholas with William Blair.

Andrew Nicholas^ First one I wanted to ask is just around the project-based services and advisory services in particular. I appreciate the color in the prepared remarks around on some of the things that you're seeing there. But if you could just speak a bit more to the pipeline for fourth quarter and maybe more broadly on the health of your clients in that industry as we look ahead to potentially more macroeconomic uncertainty in '24?

Jerry Grisko^ Yes. Andrew, this is Jerry.

As you know, there's a number of different businesses that comprise our advisory services, and they serve different clients. Oftentimes, when we talk about our advisory services, a lot of our discussion is around our private equity group. So let me start there.
As we mentioned in our remarks, what we're seeing this year compared to last year -- and by the way, we're very pleased with the results that we're seeing, albeit it's coming in, in a little bit of a different form last year and the year before, with the very hot M&A market, frothy M&A market, we tended to see fewer but much larger transactions and we are working on those platform type transactions. This year, we're pleased to see, again, strong demand, albeit smaller projects for a much larger number of engagements. So it's just coming in, in a different form. When you look forward, you asked about Q4 and into '24, it's very hard for us to really predict.

As you know, that work is project-based. It tends to be more or less predictable -- I'm sorry, less predictable.

So far, this year, we're really pleased with what we're seeing. The pipeline remains encouraging for as far out as we can see it, but we really don't go into -- we don't have much visibility into -- I don't think we have any visibility, candidly, into 2024. Across the rest of the other service lines, our risk and advisory services, as you know, we made a really nice acquisition there last year. That transaction has gone very well. The combination of those businesses with our legacy business has gone very well.

We continue to see strong demand there. We also see strong demand in our valuation work. So it's a number of different services provided to somewhat different clients, but overall, quite pleased with what we're seeing so far this year.

Andrew Nicholas^ And then maybe just a question on leverage. I understand the resilience of the model and the high percentage of recurring revenue, why you're comfortable kind of in that net debt-to-EBITDA range that you've historically talked about. But I'm just curious if in the context of higher interest rates and the higher interest expense load, if there's any inclination towards prioritizing debt paydown in the current environment since interest expense is dampening your earnings growth to a certain extent right now. Just kind of broader thoughts on the capital structure.

Jerry Grisko^ We're not uncomfortable at 1.8, and I think we're a little higher at the end of the second quarter. Our cash flow comes in annually on a seasonal basis. We tend to use cash in the first and second quarters. And then we generate cash in the third and even more cash in the fourth. So net for the year, we should be generating a multiple of net income versus free cash flow, okay?

In terms of the comfort level and the prioritization and the way we're thinking about it, yes, the cost of money has gotten a little more painful and we've kind of called out the headwind that we faced this year as a result of that. But I will tell you that we still have plenty of strategic acquisition opportunities in using a fully leveraged cost of money and cost of capital in there. We're still looking for IRR targets in the 12% to 15% range generally. And we'll continue to do that and we've got plenty of capacity.

You'll probably note that we've moderated our share buyback activity a little bit. Last year, we bought more shares than we bought this year.
So that's the lever we can certainly pull more actively. And so we pulled back a little bit on that, not over any concern over the amount of leverage. But just the economics of share buybacks become less attractive with the cost of money and with the success of our higher share price in combination with the cost of money.

Operator^ And our next question will come from Marc Riddick with Sidoti.

Marc Riddick^ So you guys really covered everything else that I was thinking about. But one thing I wanted to touch on, if you had a moment to maybe share some thoughts on what you're seeing with the client industry verticals, and maybe certain areas that -- and client demand that you've seen and whether or not there's been much of a shift at all in particularly things like retail and auto as it relates to the strikes. I was wondering if there's anything that -- any call outs that you've seen in those areas or any others within the client industry verticals.

Jerry Grisko^ Yes. Let me just remind you that we're not overly concentrated in any one industry or any one geography. So the -- my comments are all kind of, to start there, which is no material impact on our business. Our clients, as you know, tend to be middle-market businesses. They tend to be a pretty optimistic and resilient group.

We go out every quarter and informally survey our offices and ask them to give us feedback on what they're seeing with their clients. So that's really the backdrop for the comments I'm about to make. I would say that our clients remain generally optimistic about their ability to navigate in this environment, although I would say somewhat tempered from the prior quarters, more recent quarters that we've talked about it. Some of the items on their list, on their talk track around, of course, as everyone else, inflation and interest rates, access to credit. With all of that said, demand for our services continues to be strong. Our core services and as I commented earlier, we're also pleased with the demand for the more project-oriented services, which can be more discretionary at times.

So across the board, very pleased with what we're seeing as far as the demand. And as far as industries are concerned, again, not overly concentrated in any one industry. If I had to say, as you would expect, the one industry that we're kind of hearing some notes of caution relates to construction and real estate. And that's really just the cost of capital and access to capital. Again, not an overly concentrated industry for us, but if I had one area where we're getting some cautionary notes, it would be there.

Ware?

Ware Grove^ Yes. The only thing I'll add on real estate. And yes, we've got our eyes on that. And most of our exposure, if we talk about serving real estate clients, most of the exposure there is on residential multifamily real estate as opposed to commercial. So I wouldn't consider our commercial real estate exposure to be extremely high, although as Jerry mentioned, we've got our eyes on it.
Marc Riddick^ And then actually, the M&A commentary, and we really appreciate you spending time and giving color on that. The M&A commentary was actually somewhat encouraging, even though they're smaller deals, but there seems to be activity out there. I was wondering if there are any particular industries that are kind of leading the way on that or is that generally across the board?

Jerry Grisko^ Yes. Marc, I didn't ask that specific question. I think we tend to -- just like the rest of our business within that segment of our business, our PEA advisory business tends to be pretty broad-based, so geographically and industry based. So I don't -- there's no concentration that I've heard of that's driving those comments.

Operator^ And this concludes our question-and-answer session. I'd like to turn the conference back over to Jerry Grisko for any closing remarks.

Jerry Grisko^ Thank you. As we always do, I want to start by thanking our shareholders and our analysts for your continued support and confidence in the company. I also want to take an opportunity to thank our team members who may be listening in today. When I reflect on our very strong performance so far this year, it always comes back to the unwavering commitment among our team members to provide exceptional client service and to support each other in all that we do. The commitment is obviously evident in the results that we posted and those wouldn't be possible without your dedication and support.

So I just want to close by saying thanks to each of you. And the broader audience, thank you for listening in on today’s call.

And enjoy the rest of your day.

Operator^ The conference has now concluded. Thank you very much for attending today's presentation.

You may now disconnect your lines.