Insperity, Inc. Third Quarter 2017

Doug Sharp

Thank you. We appreciate you joining us this morning.

Let me begin by outlining our plan for this morning's call. First, I'm going to discuss the details of our third quarter 2017 financial results. Paul will then comment on our recent results and our plan as we head into 2018. I will return to provide our financial guidance for the fourth quarter. We will then end the call with a Question & Answer session, where Paul, Richard and I will be available.

Now, before we begin, I would like to remind you that Mr. Sarvadi, Mr. Rawson, or myself may make forward-looking statements during today's call which are subject to risks, uncertainties and assumptions. In addition, some of our discussion may include non-GAAP financial measures. For a more detailed discussion of (1) the risks and uncertainties that could cause actual results to differ materially from any forward-looking statements, and (2) reconciliations of non-GAAP financial measures, please see the Company's public filings, including the Form 8-K filed today, which are available on our website.

Third Quarter 2017 Results

Now, let me begin today's call by discussing our record third quarter results.

Adjusted EPS increased 46% over Q3 of 2016 to $1.14 and Adjusted EBITDA increased 38% to $43 million, both significantly above the high end of our forecasted ranges. Through the first nine months of 2017, we are ahead of our initial budget having generated a 26% increase in Adjusted EPS over 2016 to $3.80.

As for the details, average paid worksite employees increased 10.5% over Q3 of 2016. The worksite employee growth resulted from new client sales, driven by a 12% increase in the average number of trained Business Performance Advisors and client retention of 99% during the quarter. Double-digit worksite employee growth continued in spite of a headwind from the disruption caused by the recent hurricanes in Texas and Florida. Additionally, we experienced an overall net loss associated with employee hiring and terminations by our client base during the quarter compared to a net gain in Q3 of 2016.

Gross profit increased 19% over Q3 of 2016 on the 10.5% worksite employee growth, as our direct cost programs trended favorably and pricing allocations exceeded forecasted levels. Benefit costs, and in particular healthcare claims, came in significantly below our forecast. Additionally, workers' compensation costs continued to develop favorably as a result of effective safety and claims management services. The elimination of double taxation of FICA and FUTA associated with the SBEA law came in at an expected level of approximately $1 million.

Third quarter operating expenses were managed below forecasted levels, outside of an additional accrual for incentive compensation tied to our outperformance during the quarter and charitable giving associated with Hurricane Harvey relief efforts. We continue to invest in our growth, including an increase in the number of Business Performance Advisors and in our technology, including our new Insperity Premier HCM platform.

Now, as a result of our growth and effective management of gross profit and operating costs, Adjusted EBITDA per worksite employee per month, which is our measure of unit profitability, increased 24% from $62 in Q3 of 2016 to $77 in Q3 of this year.

Year-to-date Adjusted EBITDA dollars have increased 18% over the 2016 period to $139 million. This is just a couple of million dollars below our full year 2016 Adjusted EBITDA due to our continued strong growth and operating performance.

Balance Sheet and Cash Flows

Now moving on to our balance sheet, due to our strong cash flow generation, we ended the quarter with $105 million of adjusted cash, up from $45 million at the end of 2016, and continue to have about $95 million available under our line of credit. Our financial strength continues to allow us to focus on shareholder return through our share repurchase and dividend programs. Thus far in 2017, we have repurchased 349,000 shares of stock at a cost of $27 million and paid $18 million in cash dividends.

Now, at this time, I'd like to turn the call over to Paul.

Paul Sarvadi

Thank you Doug. Today my comments will cover three primary topics. First, I will provide some detail regarding how Hurricane Harvey affected Insperity, and our response to the devastation caused by the storm. Secondly, I will discuss the key drivers to our continuing excellent financial performance in Q3 and year-to-date. Lastly, I will discuss our outlook for our fall campaign selling and retention season and our first impression of how 2018 is shaping up.

Our strong financial performance continued in Q3 as a result of sustained double-digit unit growth, strong pricing and management of direct costs, and ongoing operational excellence. This was in spite of the considerable disruption caused by the unprecedented hurricane in Houston, the home of our corporate headquarters.

Harvey hit Houston and the surrounding area in a manner that was epic in a number of ways. The storm lingered on for nearly a week and poured rain across a 150-mile radius with rainfall totals equal to expectations for an entire year.

This event required considerable attention for several weeks, beginning August 21st the week before the storm hit, then intensified considerably during the week of and the week immediately following the storm. This disruption has waned since but continues to some degree even now, as recovery and rebuilding efforts are still a work in progress.

Insperity has a disaster recovery plan and team that performed incredibly well when this real calamity hit. No plan can anticipate the exact circumstances of a disaster but an effective plan includes the agility to respond to whatever does occur.

In the week leading up to the storm, our team accelerated all the possible service requirements to reduce potential workloads during the event and communicated emergency plans appropriately internally and externally.

The first priority once a disaster actually strikes, is the safety and welfare of people including our own corporate employees, our clients, and worksite employees, and their families. Since we are the HR department for our clients, we are the repository for emergency contact information and a facilitator in meeting the immediate need of ensuring everyone’s safety.

This was an ongoing process for many days as widespread flooding occurred due to continual rain and necessary opening of dams and reservoirs. We have over 1,400 of our 2,750 corporate employees and over 1,200 clients with nearly 20,000 worksite employees in the affected areas, so just the effort to meet this top priority was substantial.

I am going to spare you the many details about the stages of the disaster and the agility of our response, and focus on three bottom line outcomes from the experience. First, we are not aware of a single service request from across our entire client base that went unfulfilled during the entirety of this event. This is truly amazing considering the scale and duration of this storm and I must give credit to our amazing corporate employees and our disaster recovery team.
Secondly, the demonstration of the Insperity corporate culture including the professionalism to meet commitments, the caring for clients and employees, and the support of our community at large was on full display throughout this event. This special culture that overcomes challenges to meet business and financial goals performed with flying colors when it really counted and people’s lives were at stake.

The third outcome from the storm was the temporary and limited disruption to worksite growth as we dealt with the necessary distraction of the disaster for nearly a month of the third quarter. All three drivers to paid worksite employee growth, paid from sales in the cue, retention, and net change in employment at client locations were below expectations in September resulting in unit growth slightly below our expected range for the quarter.

In spite of the interruption, we continued double-digit growth in worksite employees driven by the growth of the number of business performance advisors, maintaining sales efficiency, and solid retention. Year-to-date we are slightly ahead of sales forecast at 101% although we were slightly below forecast at 92% in Q3.

In the quarter we achieved a 14% increase in total hired business performance advisors and a 12% increase in average trained business performance advisors while maintaining the same level of sales efficiency over the 3rd quarter of last year. This demonstrates our capability to recruit and train business performance advisors and support them with effective marketing efforts.

Corporate leads, social media followers and unique visitors to Insperity.com are all up more than 30% year-to-date and for Q3. Our marketing programs including digital, channels, and customer loyalty programs are all performing well contributing 56% of sold worksite employees year-to-date.

Retention of accounts continued at a very high level of 99%, however included the termination of one of our largest accounts due to an acquisition, which we discussed last quarter. We are continuing to see very high client satisfaction levels and strong demand for our services driving these results.

Our primary drivers to unit growth remain strong, however we also saw a dynamic in the hiring within our client base this quarter worth noting. The third growth driver, largely out of our control, is the net gain or loss from clients hiring and terminating employees.

This metric has continued to run below expectations, and in fact, was negative two out of the three months of the quarter and four out of nine months of this year. This is in contrast to what our historical employment growth indicators would predict.

Overtime as a percentage of base pay was 11% and commissions paid to the sales staff of our clients was nearly 7% in Q3. This combination along with positive sentiment from business owners about the economy typically coincides with robust hiring.

We have seen an increase in job openings but filling the jobs has been more difficult of late. The labor market has shifted from employers selecting from among a number of qualified candidates to candidates selecting from among multiple employer offers. This is consistent with data and anecdotal information from our recruiting division regarding the difficulty finding qualified candidates, the length of time to fill positions, and candidates indicating they have multiple opportunities.

The big picture on growth year-to-date is we continue to drive double-digit growth throughout the year in spite of weaker than expected net gains in the client base, the loss of one of our largest clients, and the interruption of Hurricane Harvey.

In spite of the slight volume variance experienced in the quarter and year-to-date, two underlying trends in other aspects of the business have allowed us to outperform at the bottom line. Our pricing strength and management of direct costs has combined with our operating leverage more than offsetting slightly lower unit growth.

At this point of the year, it is critical to have momentum in our fall selling and retention efforts in order to have a successful year-end transition in new and renewing accounts. This is important to achieve a starting point in paid worksite employees in January to continue our strong multiyear trends in our financial performance.

The most important metrics to focus on at this point in the campaign are mid-market sales and retention, and the pipeline of business profiles for new core sales. We look at mid-market sales in the pipeline and midmarket termination notices scheduled for January to see if we are on target for our baseline objective of offsetting terminations with new sales in this segment.

At this point, we appear to be in good shape on this front with midmarket sales scheduled for January payroll running ahead of terminations. This can certainly change over the quarter but so far so good.

In the core market, the number of business profiles has ramped up at an unprecedented pace providing confidence in achieving our targeted sales goals for the fall. We have to execute effectively in closing and enrolling accounts, but it is always comforting at this point to see a full pipeline.

It is too early to get a measure on retention in the core market but we are encouraged due to stable pricing on our direct costs including benefits and corresponding minimal plan design changes for the benefit plan year ahead. This combination historically supports high retention at year-end.

We also have the added advantage of the introduction of Insperity Premier™, which we announced this quarter. This unique co-employment HCM platform has been very well received, and we are on track with the roll out of this upgrade. Over one-third of our cloud-based activity is already occurring on the new platform and we expect to reach our target of completing this upgrade by year-end.

Therefore, we have a relatively high level of confidence of a successful fall selling and retention campaign and year-end transition ahead. Our confidence is also bolstered by the past three years in a row where our execution through this period each year allowed us to start the New Year at double-digit growth rates.

This quarter we will be completing our detailed budget for 2018 so we will not provide specific guidance until next quarter. However, we can provide some high level information to frame next year.

First, we are ahead in total hired Business Performance Advisors exceeding our target of 475, which was our goal for year-end. This is the most important key metric for driving consistent predictable growth into the future. Therefore, we expect to continue double-digit growth in worksite employees next year, with the range dependent on starting point, which we will know in January.

Our outlook for profitability is also favorable with positive trends in pricing and direct costs including the full year benefit of certification under the Small Business Efficiency Act.

We would expect for some level of operating leverage to continue offset by investments in BPA growth, office expansion, marketing and technology investment. We will determine this in the budgeting process this quarter.

When you put these pieces together, we would expect adjusted EBITDA growth slightly above unit and gross profit growth rates. As usual we will be conservative early in the year and work a plan to control risk and costs throughout the year to build that spread, similar to the last few years.

In summary, we have had an excellent year so far and we are all systems go for a strong finish to 2017. We are in a position for a successful fall selling and retention campaign, which we believe, will set us up for continuing our outstanding financial performance and superior returns to shareholders next year.

At this time, I would like to pass the call back to Doug.

Doug Sharp

Third Quarter and Full Year Guidance

Thanks, Paul.

Now, before we open up the call for questions, I'd like to provide our financial guidance for the fourth quarter and some comments on our general outlook as we look ahead to 2018.

As for worksite employee growth, we continue to expect strong sales and client retention over the remainder of the 2017. When combined with our starting point for Q4, coming off of the storm impacted third quarter, we are now forecasting fourth quarter average paid worksite employee growth to be in a range of 10.0% to 11.0%.

We are increasing our full year Adjusted EPS guidance based upon our strong year-to-date results and an improved Q4 outlook in our pricing and direct cost programs. We are now forecasting an increase of approximately 32% in adjusted EPS for the full year 2017 over 2016, up from our previous guidance of 25% to 28% and our initial 2017 guidance of 17% to 23%. Q4 adjusted EPS is projected in a range of $0.91 to $95, an increase of 57% to 64% over Q4 of 2016.

As for adjusted EBITDA, we are forecasting a range of $36 million to $38 million for the fourth quarter, which is a 56% to 65% increase over Q4 of 2016. This puts us on target for a 25% increase in full year 2017 adjusted EBITDA over 2016 to approximately $176 million, and a record level of $80 per worksite employee per month.

Adjusted EBITDA per worksite employee per month is a key metric for our business, as it is a measure of our ability to effectively manage pricing, direct costs, operating expenses and risk while growing worksite employees at targeted levels. We have experienced a consistent improvement in this metric from $54 in 2014 to $63 in 2015 to $71 in 2016, and now forecasting $80 in 2017. This demonstrates the successful management of gross profit and leverage of our cost structure while achieving double-digit worksite employee growth over the past three years.

As we look forward beyond 2017, and continue to execute on our strategic plan, our goal will be to continue double-digit worksite employee growth with slightly higher adjusted EBITDA growth on improved pricing, effective management of direct costs, and continued operating leverage.

In conclusion, we are pleased with our strong growth and profitability in 2017 and are now focused on closing out a successful fall sales campaign and year-end renewal period to position us for a strong 2018. We will be providing detailed 2018 guidance on our next earnings call and look forward to talking to you then.