Insperity, Inc. Third Quarter 2018

Introduction

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 behind our third quarter 2018 financial results. Paul will then comment on our recent results and our plan, as we head into 2019. I will return to provide our financial guidance for the fourth quarter and an update to our full year 2018 guidance. We will then end the call with a Question & Answer session.

Now, before we begin, I would like to remind you that Mr. Sarvadi 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 2018 Results

Now, let's discuss the details behind our strong third quarter results. We once again achieved record high operating results, reporting $0.96 in Adjusted EPS, a 68% increase over Q3 of 2017, and Adjusted EBITDA of $62 million, an increase of 43%. These results were driven by an acceleration of worksite employee growth into the mid-teens, and effective management of pricing, direct cost programs and operating costs.

As for some of the details:

Average paid worksite employees increased 15% over Q3 of 2017, accelerating off of Q2's growth of 13%. This quarter's growth was driven by continued strong sales, a high level of client retention and net hiring by our clients. As for our sales efforts, worksite employees paid from new sales in our "core client segment" increased by 26% on a 16% increase in the average number of Business Performance Advisors. When combined with the recent success in our MidMarket segment, including the enrollment of our largest account to date, total worksite employees paid from new sales increased by over 50% compared to Q3 of 2017. Additionally, client retention during the third quarter totaled over 99%, as we remain on track to hit the recent historical highs of 85% to 86% for the full year 2018. We also experienced a slight increase in net hiring by our client base over Q3 of the prior year.

The worksite employee growth, combined with effective pricing and management of our direct cost areas, drove a 19% increase in gross profit over Q3 of 2017. These results included a 2% increase in benefits cost per covered employee and workers' compensation costs, as a % of non-bonus payroll, generally in line with Q3 of 2017. The resulting gross profit per worksite employee per month increased from $250 in Q3 of 2017 to $257 in Q3 of this year.

Q3 adjusted operating expenses increased 8% over Q3 of 2017, as we leveraged various areas of the business, while continuing to invest in in our growth, technology and product and service offerings. In addition to the increase in the number of Business Performance Advisors, we have opened 6 new sales offices thus far in 2018. We have also continued to invest in (1) service personnel with client growth, particularly with the recent success in the midmarket area, (2) our client-facing, back office and cybersecurity technology, and (3) our traditional employment offering.

Our effective tax rate in Q3 came in at 26%, which we continue to expect to be our 2018 full year rate.

Now, these Q3 results coming off of the strong first half of the year, has resulted in significant top and bottom line growth for the three quarters ending September 30th. Gross profit has increased 21% on a 14% increase in the average number of worksite employees. And, when combined with just a 13% increase in adjusted operating expenses, adjusted EBITDA has increased 38% to $192 million. And finally, when combined with a lower effective tax rate, Adjusted EPS has increased 61% to $3.06.

Balance Sheet and Cash Flows

As for our balance sheet and cash flow, we ended the quarter with $167 million of adjusted cash and have $245 million available under our line of credit. Through the three quarters ending September 30th, we repurchased 212,000 shares of stock at a cost of $16 million and paid $25 million in cash dividends. We have repurchased an additional 186,000 shares, at a cost of $20 million, during the month of October under our corporate 10b5-1 plan.

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

Paul Sarvadi

Thank you Doug. Thank you all for joining us to discuss these truly outstanding record results for Insperity. We are continuing to see strong execution of our business plan across the entire organization driving these extraordinary outcomes.

Today my comments will address three topics driving value creation at Insperity. First I will discuss our growth acceleration and strong profitability reflected in our recent results. Second, I will cover the focus of our fall selling and retention campaign and our confidence level as we look forward to 2019. And finally I will comment on our dynamic business model we continue to refine, which is producing consistent, predictable, outstanding performance.

I will be brief in my comments regarding the recent quarter, because frankly, the numbers are so strong they speak for themselves. Strong sales momentum, continuing exemplary client retention and a robust small business economy all contributed to growth acceleration greater than 15%, 16% and 19% in worksite employees, revenues, and gross profit respectively over the same period last year.

Paid worksite employees from new sales in the third quarter increased 58% over the same period last year and included the enrollment of our largest client ever. We have accelerated our growth rate in Business Performance Advisors from 12% to 16% over the last two years and our unit growth rate in the number of paid worksite employees has followed accordingly.

New sales for the third quarter were strong coming in at 99% of budgeted levels as sales efficiency was maintained at nearly the same level as last year in spite of the significant increase in new Business Performance Advisors. This is a credit to the ongoing sales training and management in place.

In addition, our marketing programs continue to provide sufficient leads to reach our sales targets. In the third quarter marketing sourced leads increased 41% over last year driven by continued success in digital, channel, and loyalty programs.

Client retention, continued at historically high levels, above 99% this quarter. This is certainly a credit to our employees across the company, meeting and exceeding expectations of clients throughout the country every day.

The third contributor to our growth rate is the net effect of new hires and terminations of employees within our client base. Net hiring has been a positive as all three key indicators, including average pay increases, overtime, and commissions remain very strong.

Average pay for the same employees over last year is up over 4% with hourly workers benefitting the most with pay increases exceeding 5% for the first time in many years. Overtime as a percentage of base pay is over 12% confirming the need for and difficulty in finding qualified new employees. And commissions paid to the sales staff of our client was up over 13% in Q3 indicating strong sales in the small business sector.

This dynamic feeds perfectly into strong demand for our HR services providing better benefits and helping clients to attract and retain the best employees.

Our substantial outperformance in our profitability in the quarter was about half due to higher gross profit and the other half due to lower operating expenses. These results punctuate our effective management of price and cost for our services and strong execution against our operating budget.

The combination of these factors resulted in a very strong third quarter with Adjusted EBITDA up 43%, and sets the stage for a full year expectation of a 33% increase in this key metric.

The obvious momentum we have within Insperity provides a high level of confidence as we execute our important fall selling and retention campaign and look forward to our year end transition.

We expect strong sales and client retention during this critical period where we typically experience a concentration of new and renewing accounts.

We are confident in renewals of current accounts due to the benefit our clients receive from the depth of our services managing our direct cost including payroll taxes, workers' compensation and employee benefits.

We expect the stability in these cost coupled with no significant plan design changes to translate into high retention during this campaign. In addition, we are three weeks ahead of plan in communicating renewals to our client base which gets a head start on the process.

We are confident on the sales front due to the combination of consistent predictable sales from our core small business segment and several recent mid-market sales. We certainly have to execute well throughout the balance of the campaign but I believe we are in an excellent position to achieve our fall campaign sales targets.

We have two additional priorities in this fall campaign that are important going forward. The first is an emphasis on optimizing pricing through a consistent, transparent approach to comparing cost for prospects in the sales process. We have recently completed a training program to help our Business Performance Advisors demonstrate the value we deliver to clients and support our pricing model.

The second is boosting sales activity in our new Workforce Acceleration traditional employment bundle. This new option for prospects represents an important new revenue stream for the future for Insperity and a refinement to our business model.

Assuming we stay on track and are successful in our fall campaign, we should be in good shape for our starting point in paid worksite employees for 2019. At this stage, we are comfortable in budgeting a growth rate for paid worksite employees for next year in the low to mid-teens similar to what we achieved this year.

We always use a healthy level of conservatism in our budgeting process which will take place over the next several weeks. At this point, I would expect to end up with a budget for 2019 with growth in Adjusted EBITDA and Adjusted EPS at rates slightly higher than our unit growth.

Similar to this year, we will begin next year with a conservative view of gross profit and allow upside to come in as we effectively manage these costs throughout next year.

For my last topic today, I would like to focus on our exemplary business model and the consistent, predictable results that are produced when execution is on target. The model is designed to provide multiple ways to drive double digit unit growth, solid unit profitability at the gross profit line, and operating leverage to produce impressive double digit growth in Adjusted EBITDA.

The front of the ship for our business model at Insperity is the number of trained Business Performance Advisors in the marketplace and their sales efficiency in introducing our unique services to the best small and mid-sized companies in America.

The breadth of our services in both the co-employment and traditional employment space distinguish Insperity offerings as the most comprehensive business services platforms in the marketplace. Our industry leading technology coupled with our consultative expertise delivers “software with a service” that drives improved business performance for our clients.

Historically, the rate at which we grow the number of Business Performance Advisors translates directly into our growth rate in paid worksite employees as long as we can maintain sales efficiency.

More recently, as we have succeeded in the mid-market space, we have turned this segment into a premium to our growth rate. This opens up the potential for the worksite employee growth rate to exceed the Business Performance Advisor growth rate by a couple points in the future.

Mid-market sales have continued to build toward a more consistent contributor to our growth with a strong pipeline and improving close rate. This is important in driving sales efficiency which is one of the most significant factors within our business model driving growth and cost of sales.

The next major element of our model is the matching of price and direct cost in order to achieve targeted levels of gross profit per employee. Our track record in this area has allowed us to provide a tremendous advantage to our clients in the form of optimized pricing and stabilized employment costs.

This level of depth of our services has also allowed us to earn the highest gross profit per employee in our industry. This is important because each worksite employee is also a unit of employment risk in our co-employment model.

When we are successful matching pricing and the corresponding direct costs we are able to grow gross profit at a slightly higher rate than our unit growth.

Our model also contemplates operating leverage from fixed and semi-variable cost that escalate at a rate slower than our unit growth. Sales, service, and technology cost generally escalate more in line with unit growth, while administrative and infrastructure costs offer operating leverage.

When you put all these factors together, Adjusted EBITDA can grow at a substantially higher rate than our unit growth, similar to what we are seeing this year. Our growth rate in Adjusted EBITDA has exceeded 26% the last three years and is expected to be over 30% this year demonstrating the capability of our business model to perform at a very high level over an extended period of time.

While the financial elements of our business model are certainly impressive, the most amazing aspect of our business model is that it allows our employees provide a unique level of care to our small and mid-market clients, their employees and families.

Insperity has over 3,100 employees dedicated to helping businesses succeed so communities prosper. Helping clients have the best possible place to work in order to attract and keep the best employees is critically important today, and always a driver to business success.

This week Insperity was recognized as the number 1 Best Place to Work in Houston by the Houston Business Journal for the fourth year in a row. This is no small feat in the Nation's fourth largest city in the country.

This represents the 145th time we have received this type of recognition in cities across the country since we began participating in these programs. It is important for Insperity to walk the walk as a best place to work to demonstrate our capability to help clients do the same.

So in summary, Insperity is continuing to execute and perform at a very high level and we are optimistic we are on track to continue strong performance into 2019.

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

Doug Sharp

Fourth Quarter and Updated Full Year 2018 Guidance

Thanks, Paul.

Now, before we open up the call for questions, I'd like to provide (1) our financial guidance for the fourth quarter, (2) an update to our full year 2018 guidance and (3) some comments on our general outlook as we look ahead to 2019.

We expect strong sales and client retention to continue over the remainder of 2018 driving a further acceleration in worksite employee growth. We are now forecasting fourth quarter average paid worksite employee growth to be in a range of 16% to 17%, up from Q3's growth of 15%. This would result in growth for the full year in a range of 14% to 14.5%, up from 10% in 2017.

We are increasing our 2018 earnings guidance based upon the strong year-to-date results and an improvement in our outlook over the remainder of the year driven by the higher worksite employee growth rate. Q4 adjusted EPS is projected in a range of $0.63 to $0.67, an increase of 15% to 22% over Q4 of 2017. This would result in an increase of approximately 52% in adjusted EPS for the full year 2018 to a range of $3.69 to $3.73.

As for adjusted EBITDA, we are forecasting a range of $44 million to $46 million for the fourth quarter, which is a 14% to 19% increase over Q4 of 2017. This puts us on target for a 33% increase in adjusted EBITDA for the full year 2018 over 2017 to approximately $237 million.

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 over the past five years from $54 in 2014 to $81 in 2017, and are now forecasting $95 in 2018.

In conclusion, we are pleased that 2018 is shaping up to be a year of record earnings and are now focused on closing out a successful fall sales campaign and client renewal period to position us for a strong 2019. As we continue to execute our strategic plan, our initial budget will be for continued worksite employee growth in the low to mid-teens, with slightly higher adjusted EBITDA growth on improved pricing, effective management of direct costs, and continued operating leverage. We will be providing detailed 2019 guidance on our next earnings call and look forward to talking to you then.