Insperity, Inc. Second Quarter 2017

Doug Sharp

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 of our second quarter 2017 financial results. Paul will then comment on our strong recent results and our strategic plan for long-term growth and profitability. I will return to provide our financial guidance for the third quarter and an update to the full year 2017 guidance. 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.

Second Quarter 2017 Results

Now, let me begin today's call by discussing our strong second quarter results.

Adjusted EPS increased 37% over Q2 of 2016 to $0.82 and Adjusted EBITDA increased 30% to $33.3 million, both significantly above the high end of our forecasted ranges. Through the first six months of 2017, we are ahead of our initial budget having generated a 19% increase in Adjusted EPS over 2016 to $2.65, and $96 million of Adjusted EBITDA.

As for the details, average paid worksite employees increased 10% over Q2 of 2016, as all three drivers to growth produced positive results. Worksite employees paid from new client sales increased 26% over Q2 2016 on a 13% increase in the average number of trained Business Performance Advisors and the enrollment of recent midmarket sales. Secondly, client attrition improved 32% from Q2 of 2016, averaging only a half of one percent during the quarter. And, net gain in our client base, which had been weak in recent quarters, turned positive. This net gain included the typical seasonal summer help, along with modest growth of full-time employees at existing clients.

In addition to achieving double-digit worksite employee growth, we successfully managed gross profit to an increase of 15% over Q2 2016. Our pricing allocations were in line with budgeted levels, while each of our direct costs trended favorably. In particular, our benefit costs which came in higher than budget in Q1 of this year settled back down to our initially budgeted trend in Q2. Additionally, similar to recent quarters, our workers' compensation program continued to produce positive results.

You may recall that at the beginning of June we announced the receipt of the Certified PEO designation from the IRS. A significant component of this designation included the elimination of double taxation of FICA and FUTA when a business contracts with a Certified PEO during the year. Due to the timing of the receipt of this designation, any favorable impact from the elimination of the double taxation was minimal during the second quarter, however will be more significant over the remainder of the year.

Second quarter operating expenses were managed to budgeted levels and included planned investments in our growth, including the increase in Business Performance Advisors, and investments in our technology infrastructure, security and development. These investments were largely offset by operating leverage in other areas of our business to result in only a $1 increase in operating expense per worksite employee per month from $198 in Q2 of 2016 to $199 in Q2 of this year.

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 19% from $52 in Q2 of 2016 to $62 in Q2 of this year.

Balance Sheet and Cash Flows

As for our balance sheet and cash flow, we ended the quarter with $48 million of adjusted cash and have $95 million available under our line of credit. We continue to focus on shareholder return having repurchased 211,000 shares of stock at a cost of $16 million and paying $6 million in cash dividends during the second quarter.

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

Paul Sarvadi

Thank you Doug. We are very pleased to report these strong results in the second quarter and the continuing excellent execution driving our growth and profitability. We have a high level of confidence regarding the strategy we have in place and our ability to capitalize on the tremendous market opportunity in front of us.

Based upon our guidance updated today, our adjusted EBITDA for 2017 is expected to be approximately $170M, which is more than double over the last three years from $84M in 2014. Over the same period, adjusted EPS is expected to more than triple from $1.43 per share to approximately $4.50 per share.

These three years represent the full implementation of our strategic plan, which has resulted in this strong performance. However, we believe we are just beginning to demonstrate the potential for long-term growth and profitability from this strategy.

Today I would like to focus on the major elements of this proven strategy, which we expect to continue to drive double-digit unit growth, increased gross profit contribution, operating leverage, and exceptional financial performance in 2018 and beyond.

There are five strategic elements driving our performance in our unique business model. These include clear and concise strategies around growth, products and services, competitive positioning, gross profit contribution, and operational excellence.

The Insperity growth engine is based upon our wealth of experience and deep understanding of our target market comprised of the best small and midsized companies in America. Our overarching strategy is to aggregate these best businesses on to a common platform offering services and support to improve both the likelihood and degree of their success. This laser focus on the customer is at the heart of Insperity's success.

Our growth strategy is built around a dedicated team of highly trained and experienced professionals we call Business Performance Advisors that serve in a consultative role to business owners. The three key metrics; the number of Business Performance Advisors, their sales efficiency selling our flagship Workforce Optimization® co-employment solution, and their proficiency selling other traditional employment solutions drive the growth model.

The objective of our growth strategy is to produce consistent predictable double-digit unit growth in paid worksite employees in the co-employment relationship and supplement this growth with additional gross profit contribution from traditional employment offerings. In order to achieve this goal, the key success factors are the recruiting and training of Business Performance Advisors and district managers, and driving sales activity.

Over the last three years we have demonstrated our proficiency growing our Business Performance Advisor channel at double digit rates resulting in double digit unit and revenue growth at targeted levels. This core sales team, now with approximately 450 Business Performance Advisors, is continuing to meet or exceed sales and sales efficiency objectives, which adds to our confidence in continuing these strong growth rates.

Another important element of our growth strategy is our marketing effort positioning Insperity as the premium business service in the marketplace. Targeting qualified prospects through channels, loyalty programs, and a robust digital presence is designed to achieve both volume and price objectives.

The right volume of high quality leads improves sales efficiency, and positioning our offerings appropriately supports our premium pricing. Year-to-date, our marketing programs have delivered an increase greater than 30% in discovery calls, business profiles and closed business resulting in 53% of the worksite employees sold. This demonstrates our capability to drive sales activity and feeds our optimism for the future.

Another significant aspect to our successful growth strategy is our mid-market segment, which represents a premium to our growth rate and doubles our addressable market.

In years past, accounts that started out small and grew to several hundred or more employees many times were acquired, or opted to take HR services in-house. This “success penalty” resulted in a higher level of volatility and a governor to our growth rate.

Over the last several years, we have solved our “success penalty” by improving our service model retaining more large accounts and developing a capability to sell accounts of this size. With this progress, our likelihood to continue double-digit growth rates from period to period has greatly improved.

As an example, we expect to see growth acceleration this quarter even though one of our largest clients, with over 1,500 worksite employees, was recently acquired.

Our mid-market success, especially during our critical year-end transition over the last three years, has been essential in achieving our recent growth targets. Success in this segment of our business is another reason for confidence in our ability to grow at targeted rates going forward.

Our product and service strategy has also proven effective over the last several years. Insperity™ Workforce Optimization™, our co-employment solution, has been the most comprehensive business service in the marketplace for many years. By adding a wide array of business performance solutions in the traditional employment space we have developed a breadth of services to cast a wider net in the marketplace, and increase the return on our investment in the Business Performance Advisor channel.

The objectives of our product and service strategy are; to increase Workforce Optimization sales, establish a “customer for life” capability in order to grow our customer base faster, and create a mass customization capability to improve retention and maintain our pricing strength.

A major catalyst to move this strategy forward at a faster pace is the recent introduction of our traditional employment bundle called Workforce Administration.

Our wide array of business performance solutions are used by our business performance advisors to develop a customized multi-product solution for each prospect they encounter. Business Performance Advisors are trained to use a “bundle plus” approach with either Workforce Optimization or Workforce Administration as the core bundle along with additional offerings to meet client needs.

This customized multi-product approach in a Workforce Optimization sale can increase the likelihood of closing by adding cost saving solutions with the core bundle to offset the investment typically required for this premium service. For prospects not ready for the leap all the way to co-employment, Workforce Administration increases the likelihood of bringing a new customer into the fold with an opportunity to upsell to Workforce Optimization later.

These options also create more flexibility for Insperity to meet clients’ needs throughout the lifecycle of our clients. Our significant improvement in client retention over the last three years, including another record in this quarter, validates this strategy.

Our competitive positioning strategy also adds to our confidence in the future. Our breadth of services, depth of services, and level of care for our customers has created quite a moat around our business model. These three factors differentiate Insperity in the marketplace as a category of one.

Our depth of service capability is rooted in our mastery and domain expertise in all things HR. Our services are delivered on an advisory platform from our Business Performance Advisors in the field designing solutions and our HR experts serving customers daily, to our professionals at our corporate headquarters managing employment costs and navigating the troubled waters of regulatory compliance.

We have also demonstrated a unique capability over the years to manage employment costs from payroll taxes and workers compensation to employee benefits and other employer liabilities. This depth of expertise delivers on our strategic objective to bring group buying power to the small and medium size business marketplace along with the advantage of stable costs.

This expertise also provides the opportunity for Insperity to earn a fee for managing these employer costs, which contributes to our gross profit. In addition, our traditional employment solutions represent a third contributor at the gross profit line in our model, which has helped to fend off competitive pricing pressure in the marketplace.

Further evidence of our depth of service capability is in our technology team delivering on our “software with a service” objective. Our announcement today of Insperity Premier™ is another milestone providing a true HCM experience within our co-employment Workforce Optimization solution.

We believe Insperity Premier is a game changer by adding new features and functionality, expanding and customizing client specific data collection and reporting, integrating products into modules, and delivering a more “HCM like” user interface.

This platform is designed specifically for our deep integrated relationship with our clients, including new co-browsing and click to chat capability, allowing our HR professionals to work even more closely with supervisors and managers at client locations in real time.

The roll out of this upgrade is in process and will continue for the balance of the year. It is too early to accurately predict the benefit of this new platform on sales, retention, or cost reduction, however early anecdotal evidence is very promising.

Insperity Premier is a perfect example of how technology can combine with service professionals to increase the level of care and improve the customer experience. This level of care has distinguished Insperity in the marketplace for many years and is the hardest for competitors to replicate.

The true measure of operational excellence over the past several years is evident in the level of care we have provided clients, while at the same time delivering operating leverage through efficiency gains. Our key metric in this area is the number of worksite employees served per service provider, which has increased from 200 to 1, to 265 to 1 over this period.

Our customer for life and software with a service strategies have proven successful at achieving these results and our improvement in client retention is validation of the excellent execution in this area.

In summary, our strategic plan is in place with more ways than ever to achieve desired results, and we are optimistic about our ability to continue to deliver outstanding operating results and exceptional returns to our shareholders.

As a result of executing this strategic plan over the last three and a half years, we have returned over $400M to investors, 290M in share repurchases, and an additional 123M in dividends, demonstrating our ongoing commitment to exceptional shareholder returns.

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 third quarter and an update to our full year 2017 forecast, which is substantially higher than our initial guidance.

We continue to forecast full year growth of average paid worksite employees in a range of 11% to 12%. We are forecasting Q3 worksite employee growth in a range of 11.0% to 11.5%. This is an acceleration off of Q2's growth of 10% when considering improved sales associated with the increase in the number of Business Performance Advisors, partially offset by the loss of the large midmarket client in July.

As for our gross profit area, we have incorporated recent pricing and direct cost trends in our updated guidance. We have also considered some benefit in the payroll tax area associated with the elimination of double taxation of FICA and FUTA resulting from our recent PEO certification under the Small Business Efficiency Act. The combination of this benefit, partially offset by the loss of the large midmarket client, should contribute approximately $2 million of additional gross profit over the second half of the year. As for operating expenses, these costs continue to track our budgeted plan.

So, when combining our better than expected results for the first half of 2017 with our outlook over the remainder of the year, we are increasing our forecast of Adjusted EBITDA to a range of $169 million to $173 million, a 20% to 23% increase over 2016. As for Q3, we are forecasting adjusted EBITDA of $37.5 million to $39.5 million, a 20% to 26% increase over 2016.

We are now forecasting full year 2017 adjusted EPS of $4.47 to $4.60, a 25% to 28% increase over 2016. This is an improvement over our initial guidance in which we were forecasting a 17% to 23% increase over the prior year. Q3 adjusted EPS is projected in a range of $0.94 to $1.00, an increase of 20% to 28% over Q3 of the prior year.

In conclusion, we are pleased with the strong top and bottom line growth trends in our business and look forward to updating you on our progress over the remainder of the year.