

Insperity, Inc. Third Quarter 2016

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 strong third quarter 2016 financial results. Paul will then comment on the key drivers behind our Q3 results and how we are positioned entering our fall selling season and year-end renewal period. Richard will then join us for this call to comment on the recent trends in our gross profit area as we approach 2017. I will return to provide our financial guidance for the fourth quarter of 2016 and some comments on our operating cost structure and general outlook as we enter next year. We will then end the call with a question and 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 2016 Results

Now, let me begin today's call by discussing our record high third quarter and year-to-date results.

Adjusted EPS increased 37% over Q3 of 2015 to \$0.78 and Adjusted EBITDA increased 11% to \$31.3 million, both above the midpoint of our forecasted ranges. Through the nine months of 2016, we remain ahead of our initial budget having generated a 62% increase in Adjusted EPS over 2015 to \$3.01 and a 27% increase in Adjusted EBITDA to \$118 million.

As for the details, average paid worksite employees increased by 13.3% during the quarter to approximately 168,900. This was below our forecasted range of 14.0 to 14.5% worksite employee growth, due to lower than expected hiring within our client base. Surprisingly, net hiring by our clients declined sequentially from the first half of this year and by just over 50% from Q3 of 2015. However, our double-digit worksite employee growth continues to be driven by (1) a high level of client retention, which averaged over 99% for the quarter, and (2) an increase in sales driven by continued growth in the number of trained Business Performance Advisors and improvement in their sales efficiency.

Gross profit increased by 10% over Q3 2015, and as always included positives and negatives within the components of price and cost. This quarter included a positive

impact of effectively managing our workers' compensation program, including closing out claims at lower than expected costs, which offset a higher than expected level of large health care claims.

Q3 adjusted operating expenses were in line with our operating plan, increasing 9% over the third quarter of 2015, and included the continued growth in the number of Business Performance Advisors, while producing operating leverage in other areas of the business. This is demonstrated by a decrease in adjusted operating expense per worksite employee per month from \$194 in Q3 of 2015 to \$187 in Q3 of this year, inclusive of the increase in Business Performance Advisors. For the nine months ended September 30th, on a 14% increase in average paid worksite employees, adjusted operating expenses increased by just 6% over 2015.

Putting all the pieces together, adjusted EBITDA per worksite employee per month, increased to \$80 for the nine months ended September 30, 2016 from \$72 in the 2015 period.

Balance Sheet and Cash Flows

As for our balance sheet and cash flow, we ended the quarter with approximately \$68 million of available cash. In addition, we continue to have \$95 million available under our line of credit. During Q3, we repurchased 136,000 shares, bringing the year-to-date total to just over 3.2 million shares, with a majority of the shares acquired through our Dutch auction tender offer in January. We've also paid out approximately \$15 million in cash dividends so far this year.

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

Paul Sarvadi

Thank you Doug. Today I would like to update investors on three important areas driving value creation at Insuperity. First I will discuss the recent excellent execution of our growth plan and the key drivers of our success. Second I will explain how we are set up to reach our goals over the next few months as we conduct our fall selling and retention campaign. And third, I will highlight the key factors we are driving to set up another strong growth year in 2017.

The solid execution and financial performance we are experiencing at Insuperity is the result of an intense focus on sales, retention, risk management, and service excellence with a Customer for Life philosophy. This philosophy enables us to start a relationship with a new client wherever they need us the most and continually and proactively meet changing client needs over time.

Our industry leading Workforce Optimization™ solution and our wide array of business performance solutions combined with our service culture and clear mission provides a powerful growth opportunity today and for years to come. This quarter's results provide a good example of strong execution of our controllable factors in the face of a tepid economic climate and weaker than expected labor market.

During this period our retention continued at record levels and our sales engine continued on a solid pace. The combination of over 99% retention and a 10% increase paid worksite employees from sales over the same period in 2015 drove our 13% increase in worksite employees in spite of weakness Doug mentioned in hiring in the client base.

In the third quarter, business profiles which represent opportunities to quote our services were up 12% over 2015. From this activity, we experienced a 19% increase in new Workforce Optimization™ clients sold representing a 12% increase worksite employees sold. Margins increased slightly up 2%, and sales efficiency as measured by the number of sales per Business Performance Advisor per month also increased 4% which is excellent considering we are growing the salesforce substantially.

In addition, sales orders of our additional business performance solutions packaged with our Workforce Optimization™ offering or on a standalone basis were up 20% over Q3 last year. This activity contributes at the gross profit line and provides new clients to upsell to Workforce Optimization™ in the future.

At this time of year, it is important to take a little closer look at the month of September as proxy for what may ensue in our fall sales and retention campaign. In September we set a record in the number of Business Performance Advisors in the field and the number of business profiles, and we exceeded our monthly internal budget for sales. Although it is only the first month of the fall campaign, we are off to an excellent start with sales up 20% over last year driven by an increase in sales efficiency of 13%.

Our marketing activity has been very productive year to date which also provides some confidence for this fall. Corporate provided leads are up 53% over last year as we expanded our loyalty and channel programs and increased our digital marketing efforts. The leads provided by these marketing programs led to 40% of the worksite employees sold year to date. Providing more quality leads is also playing a key role in driving sales efficiency even as we grow the salesforce.

Our digital footprint is also expanding and creating sales opportunities. Unique visitors to Insperity.com were up 71% in the recent quarter while social media followers were also up over 76%. Worksite employees sold from digital marketing leads followed this activity leading to a 58% increase over the same period last year.

Another key factor to consider for this fall is the stability in pricing and plan design we are able to offer our prospects and current clients. In the face of the horror stories of Obamacare increases and lack of access to insurers and providers, our plans stand in stark contrast as a stable cost effective high quality alternative.

Our success in this area offers tremendous benefit to our clients by providing stability in costs and networks, and ultimately in the ability to hire and retain employees. This year we have few plan design changes and modest price increases which typically supports our year-end client retention efforts.

There is one factor that has been and may continue to be a bit of a headwind throughout this fall campaign. There is a considerable level of uncertainty connected with the unusual election cycle we are experiencing. This may have been a factor in recent

weakness in hiring within our client base and has caused some delay in signing midmarket clients. So as we look for a strong fall campaign and year end transition, it is not without risk from the macro environment.

In spite of the election related uncertainty, our confidence for this year end continues to be high based on our strong start to the fall selling campaign in activity and results, our recent marketing success, and the growth of the sales staff.

The key metric as we look ahead to our growth prospects for 2017 is the number of Business Performance Advisors in the pipeline to add to the trained Business Performance Advisor count early next year. During the third quarter we had a significant emphasis on recruiting and we entered the fourth quarter with over 430 Business Performance Advisors.

We expect to continue the emphasis on recruiting and training of Business Performance Advisors as we move into next year. We also expect to continue to refine our marketing efforts to support the sales team with substantial lead flow. With this focus, we expect to continue double digit growth worksite employee growth like we have had the last two years which led to the excellent financial performance that followed.

In 2017, we also expect to continue our technology development efforts to improve the client and worksite employee experience and continue efficiency gains for both our clients and Insperity. We expect an upgrade to both our Workforce Optimization™ co-employment platform and our Workforce Administration™ traditional employment platform next year.

We are in an excellent position to capitalize on our market opportunity and our competitive advantages. We are ready, willing, and able to grow our business, lead our industry, and extend our success.

I would also like to mention another announcement we made today adding Tim Clifford to our board of directors. Tim has a strong entrepreneurial and CEO background including business, technology, and insurance service which makes him uniquely qualified to help continue our success. We welcome him to the Insperity Board of Directors.

So with our fall campaign off to a good start, and our early outlook for double digit growth next year, we have asked Richard to provide his early read on gross profit for 2017. We plan to have Richard comment from time to time to add some color on long term trends that may be of interest to investors.

After Richard comments on our gross profit outlook, Doug will provide guidance for Q4 and his thoughts about 2017 operating expenses trends completing the picture of our early outlook for 2017.

At this point I would like to pass the call on to Richard.

Richard Rawson

Thank You, Paul

This morning I have some prepared remarks on historical trends in the gross profit area and our outlook as we look ahead into 2017.

As you know our gross profit comes from a combination of:

- 1) The pricing of our service fees
- 2) The net surplus we earn from managing our direct costs and
- 3) The gross profit contribution from our business performance solution products.

Looking back over the last 5 years, our gross profit per worksite employee per month has been quite predictable considering the number and complexity of the components involved. During this time, the range has only varied a few dollars per worksite employee per month while the absolute dollars has grown almost 130% approaching \$500 million dollars.

Examining each major component of our gross profit on a worksite employee per month basis reveals the following:

- 1) Our service fee has declined as a result of the mix of business moving from our Workforce Optimization™ offering to the lower price, lower cost Workforce Synchronization™ offering and to a lesser degree general marketplace conditions.
- 2) The net surplus component of gross profit on a per worksite employee per month basis has increased as we continue to effectively manage the price and cost of payroll taxes, workers compensation insurance, health care and other benefits.
- 3) The gross profit per worksite employee per month from our business performance solutions has also increased more than 60% over the past 5 years, adding a new contributor to gross profit that does not have employer related insurance risk.

As we look forward to 2017, we see a very similar story but with a few potential bright spots, beginning with improvements in our direct costs.

This morning, we announced an amendment to our UnitedHealthcare contract. The contract, which extends through 2019, was amended in recognition of our sustained growth exceeding previous volume targets sooner than expected and it gives us a significant reduction to our administrative fees beginning in January 2017.

The long awaited Small Business Efficiency Act which is scheduled to start in 2017, eliminates the double payment of federal payroll taxes on new clients added later in the year. Additionally, state unemployment payroll taxes are expected to decline again in 2017.

After a couple of policy years that had a few very large workers' compensation claims, this most recent year has been much better as severity rates have returned to historical levels.

All of these factors are expected to cause nominal direct cost trend increases, therefore we will be passing along nominal pricing allocation increases, which should be well received in the marketplace and therefore continue to support our growth and profitability.

Due to some operational improvements coupled with product enhancements to a few of our business performance solutions, we should also see further contribution to our gross profit dollars in 2017 from this contributor.

And finally the service fee component of gross profit appears to be stabilizing, as both new and renewing customers see the ongoing value our suite of services provides them and their employees.

In summary, our ability to effectively manage and forecast our pricing and direct cost trends should allow us to see a comparable level of gross profit per worksite employee per month for 2017 and a double-digit increase in total gross profit dollars.

At this time I will turn the call back over to Doug.

Doug Sharp

Third Quarter Guidance

Thanks, Richard.

Now, before we open up the call for questions, I'd like to provide our financial guidance for the fourth quarter of 2016 and some comments on our cost structure and general outlook as we look ahead to 2017.

As for Q4 worksite employee growth, we continue to expect strong sales and client retention. However, we believe the weakness in net hiring by our clients may continue throughout the fourth quarter. Therefore, we have factored in the weakness in this non-controllable component of our growth. When combined with the positive trends in sales and client retention, we expect fourth quarter average paid worksite employee growth to be in a range of 13% to 13.5%. This would result in full year growth of 14%, which is in line with our initial 2016 budget, in spite of the weak labor market.

We are reiterating our full year Adjusted EPS guidance and tightening our range as we approach year-end. We are now forecasting an increase of 61% to 63% in adjusted EPS for the full year 2016 over 2015 to a range of \$3.53 to \$3.58. Q4 adjusted EPS is projected in a range of \$0.52 to \$0.57, an increase of 58% to 73% over Q4 of 2015.

As for adjusted EBITDA, we are forecasting a range of \$22.5 million to \$24.5 million for the fourth quarter, which is a 34% to 46% increase over Q4 of 2015. This puts us on

target for a 28% to 30% increase in full year 2016 adjusted EBITDA to a range of \$141 million to \$143 million. This equates to Adjusted EBITDA per worksite employee per month of approximately \$71, a 13% increase over 2015.

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 are projecting a 31% improvement in this metric from \$54 in 2014 to \$63 in 2015 to a 2016 forecast of \$71. This demonstrates the successful management of gross profit and leverage of our cost structure while achieving double-digit worksite employee growth in the past couple of years. The operating leverage is demonstrated by a decline in adjusted operating expense per worksite employee per month from \$225 in 2014, to \$206 in 2015 to a 2016 forecast of \$194.

As we look forward beyond 2016, and continue to execute on our strategic plan, our goal will be to continue double-digit worksite employee growth, comparable gross profit per worksite employee from effectively managing pricing and direct cost, and continued operating leverage to drive adjusted EBITDA per worksite employee.

In conclusion, we are pleased with our strong growth and profitability in 2016 and are now focused on closing out a successful fall sales campaign and year-end renewal period to position us for a strong 2017. We will be providing detailed 2017 guidance on our next earnings call and look forward to talking to you then.