Insperity, Inc. Second Quarter 2024

Introduction

Doug Sharp

Thank you. We appreciate you joining us.

Let me begin by outlining our plan for this morning's call. First, I'm going to discuss the details behind our second quarter 2024 financial results. Paul will then comment on our recent accomplishments, including an update on the implementation of our Workday strategic partnership solution, and on our outlook for the remainder of the year. I will return to provide our financial guidance for the third quarter and an update to the full year 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 I 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 2024 Results

Now, let's discuss our second quarter results in which we reported a 34% increase in adjusted EPS over Q2 of 2023 to $0.86, above the high end of our forecasted range, and a 29% increase in Q2 Adjusted EBITDA to $66 million. The earnings outperformance, compared to our expectations, was primarily driven by (1) lower than expected benefit costs, (2) continued strong pricing and (3) lower operating expenses.

As for our growth metric, the average number of paid worksite employees increased sequentially over Q1 to approximately 307,000. The increase included net growth in our client base, although at a level significantly lower than Q2 of 2023 and lower than our expectations for the typical summer hiring period. Client retention remained at an expected 99% for the second quarter. Worksite employees paid from new sales, although at a similar level as Q2 of 2023, came in below expectations. In a few minutes, Paul will comment on the current business environment impacting our prospects and clients, and the sales and marketing efforts in place to sell into this environment.

Gross profit increased by 16%, as a 1% decline in paid worksite employees was more than offset by continued strong pricing and lower benefit costs when compared to Q2 2023, which included a spike in health care costs. The combination of our other direct cost areas, including workers' compensation and payroll taxes, were generally in line with our forecast.

Q2 operating expenses were managed below plan, increasing 13% over Q2 of 2023, including $14 million associated with the implementation of our Workday strategic partnership. Our year-to-date operating expenses now include $19 million associated with this strategic partnership, along with ongoing investment in our long-term growth and our service and technology offerings.

The second quarter of 2024's effective tax rate came in at 28%, which was above Q2 of 2023's rate of 25%.

Cash Flow, Liquidity and Capital Allocation

We continued to provide returns to our shareholders through our regular dividend program and the repurchase of our shares. During the quarter, we paid out $23 million in cash dividends and repurchased 151,000 shares of stock at a cost of $14 million. We ended Q2 with $211 million of adjusted cash, an increase of $40 million over the December 31, 2023 balance. And, we had $280 million available under our credit facility.

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

Paul Sarvadi

Thank you, Doug and thank you all for joining our call. Today I will begin with comments on our solid second quarter and first half financial results in a challenging environment in the small and medium size business marketplace. I will follow up with our plans to capitalize on our market opportunity over the second half of the year, and I will finish with an update on progress on our Workday strategic partnership and the prospects for growth next year and beyond.

Our Q2 financial performance was strong exceeding the high end of our expected range in adjusted EBITDA and EPS, even while coming in at the low end of our range for paid worksite employee growth. Our strong pricing and direct cost management produced upside at the gross profit line and combined with lower operating expense to achieve financial outperformance over last year and our guidance.

Our 1% decline in paid worksite employees over the same period last year was primarily the result of our large account attrition at year end we discussed last quarter combined with the continuing effects through Q2 of the challenging economic environment in the small business community.

Last quarter we reported details indicating stress in the small business marketplace from a variety of economic issues including interest rates and inflation. This was evident from our real time internal data reflecting nominal net hiring activity, low levels of overtime pay, and a relatively low level of commissions paid to the sales personnel at client companies which we believe reflects a weak economic climate.

Our client survey information indicated a high level of optimism going into the second quarter and the potential for at least stabilization in these metrics. However, prospect and client decision making reflected a higher level of uncertainty in Q2 and net hiring in our client base weakened further than expected.

In recent quarters, and as we have seen before during periods such as these, we have seen an increased level of hesitancy in hiring and buying decisions by the small to medium size businesses. This also often leads to more aggressive sales tactics and pricing in the marketplace, further lengthening the sales cycle.

Even in the face of these headwinds over the first half of the year, we had what I believe is a significant level of success in sales. Both paid worksite employees from previously booked sales and new booked sales over the first half of the year are in line with the levels for the same period last year.

These comprised approximately 90% of targeted booked sales and paid worksite employees from sales for the first half of 2024. Even though we have a 4% increase in Business Performance Advisors out in the marketplace, I believe these are solid sales results against the backdrop of the uncertain economic and political climate.

Our client retention has continued to be strong in Q2, however nominal net hiring within our client base combined with a lower than targeted paid worksite employees from previously booked sales caused a lower starting point for paid worksite employees as we head into the second half of 2024.

The lower starting point for the second half will have an expected dampening impact within our residual income business model. We now expect lower average unit growth for the balance of the year and a shift out one quarter before significant sequential worksite employee growth would be reestablished.

The more important dynamic for consideration is the outlook for growth into next year and beyond. We believe we are very well positioned to have a strong second half in sales and retention which lays the foundation for potential growth acceleration in 2025.

Our confidence going into the second half comes from applying the learnings from the recent difficult period to improve sales and retention to reignite growth even with no help from net hiring in the client base.

We have four significant initiatives that we believe will enhance performance for the all-important fall selling and retention period over the balance of the year.

First, our implementation of Business Performance Advisor assigned accounts through our Account Based Experience marketing and sales strategy I mentioned last quarter and the corresponding training. This initiative retooled our sales motion and mobilized our entire Business Performance Advisor team for the balance of the year. This was a bit of a distraction in the second quarter but now represents a new level of opportunity to improve performance going forward.

Secondly, our marketing success over the first half of the year generated more marketing assisted discovery calls and booked sold employees than the first half of last year even in this challenging business environment. We have a new national brand campaign ready to launch that we believe will differentiate Insperity in the marketplace and increase sales opportunities over the balance of the year.

Third, we have completed a thorough evaluation of the sales and retention dynamic across the different segments of our client base. This has led to different approaches for each segment to incentivize prospects, current clients, and sales staff over the balance of the year.

And last but not least, our new strategic partnership with Workday has the potential to contribute to our sales and retention efforts ahead. Yesterday we reached the six-month point from signing our strategic partnership agreement with Workday. We completed a thorough evaluation of our progress with a face-to-face meeting of senior leadership from both firms last week in California.

We are excited with the progress to date and the commitment and investment being made by both firms to go to market together with a co-branding, co-marketing, and co-selling game plan.

All four of the key initiatives including our corporate tenant for Insperity's internal use of Workday, the client tenant which will be embedded into our PEO solution for the larger client target market, our go to market plan, and the establishment of our deployment and enablement team are all well on the way.

The Insperity corporate tenant deployment effort is on track, and we expect to begin using the Workday platform early next year. The application tenant is being built, and we plan to begin the next round of testing shortly. We are continuing to build out integrations for key systems, administrator training is ongoing, and employee training is scheduled to commence in Q4.

We believe that our experience through the deployment of the corporate tenant will provide Insperity valuable insights into the deployment and servicing of our clients on the future PEO Client tenant.

We are making excellent progress on the PEO Client tenant design and deployment efforts. We have used the learnings from the delivery of our initial foundational tenant to further shape our proposed solution design. The joint solution product definition is taking shape, and we are well down the road on the design and development of the solution.

We plan to continue to build out our client implementation and support strategy and train our providers to deliver services through the platform. We are continuing to refine our pricing model for the solution to appropriately represent the value to our clients.

The product implementations and system integrations efforts required to enable the joint solution are well underway, and our teams are tracking progress against our project plans.

We have started the pre-selection process to identify Beta clients that could be a good fit for migration to the new joint solution and support our product design process.

We have begun sharing leads between both companies and are continuing to refine our processes to act on these qualified opportunities.

We established a campaign to formally introduce the Insperity-Workday co-selling relationship directly to the sales teams, to educate each other on our sales motions. The goal is to drive an increased volume of leads exchanged over the next few months to test our systems as we head into the very active year-end selling season.

We believe there is an incredible amount of opportunity related to leveraging each company's sales investments efficiently. Insperity can meet the needs of many of these prospective clients now even before the joint solution is available.

Workday has products peripheral to their core HCM system that make a lot of sense for our current and prospective clients as well. We are working hard to put each other in the room with prospective clients that are actively searching and see value from these offerings.

We are continuing to advance our client deployment and enablement strategy. In Q3 we will begin the design of customer onboarding playbooks for both new client implementation and for existing PEO client migration to the new solution.

Another significant outcome of the first six months and the recent senior leadership meeting is the effort over the balance of the year to integrate the go to market plan into both companies' 2025 business objectives.

So, in summary, we are pleased with the first half of 2024 results against a more difficult than expected business environment. We are energized about our plans for the second half to reignite our growth into next year. And we remain excited about the possibilities for the long term, including our Workday strategic partnership. At this point I would like to pass the call back to Doug.

<u>Doug Sharp</u>
Thanks, Paul.

<u>Third Quarter and Updated Full Year 2023 Guidance</u>

We now expect earnings for the full year 2024 to be above the midpoint of our prior guidance based upon the combination of our outperformance in Q2, partially offset by slightly lower earnings expectations over the second half of the year.

As Paul just mentioned, we now expect our prospect and client base to be impacted by the ongoing uncertainty in both the economic and political environment. Given these factors, combined with the starting point going into the second half of 2024, we have lowered our full year outlook to average paid worksite employees in a range of 307,400 to 310,600, which is a decline of 0.5% to 1.5% compared to 2023.

The earnings impact of this lower worksite employee guidance over the last half of 2024 is expected to be mostly offset by strong pricing, favorable benefit cost trends and operating expense savings.

During the first half of this year, our pricing and benefit costs have been slightly favorable when compared to our initial budget. We expect these factors to continue over the remainder of the year.

As a result of our lower worksite employee outlook, we have planned on operating expense savings from our prior forecast, primarily in the areas of salaries and G&A. We will continue to focus efforts and planned spending on the implementation of the Workday strategic partnership.

Based on these factors, we are now forecasting full year 2024 Adjusted EPS in a range of $3.33 to $3.88, with the midpoint up from our previous guidance of $3.17 to $3.90. We are now forecasting Adjusted EBITDA in a range of $261 million to $290 million.

As for Q3, we are forecasting paid worksite employees down from 1.5% to 2.5% compared to Q3 of 2023. As for Q3 earnings, we are forecasting Adjusted EBITDA in a range of $32 million to $45 million and Adjusted EPS from $0.21 to $0.45. Earnings comparisons to Q3 of 2023 are significantly impacted by low benefit costs in the prior period and planned investments in the Workday strategic partnership in 2024.