

Insp erity, Inc. Fourth Quarter 2023

Introduction

Doug Sharp

Thank you. We appreciate you joining us.

I'm sure you've seen the exciting news announcing our strategic partnership with Workday released this morning. Our call today will be largely focused on this strategic partnership and how it fits into our long-term plan. However, we will begin by discussing the results of our fourth quarter and full year 2023 results and end the call with a discussion of our outlook for 2024, which includes the strategic partnership with Workday.

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.

Fourth Quarter 2023 Results

Now, let's discuss our fourth quarter results, in which we achieved \$0.75 in Adjusted EPS and \$56 million of Adjusted EBITDA, both above our expectations.

Our growth in paid worksite employees continued to be impacted by macro-economic headwinds, particularly the significant decline in hiring by our client base over the past year. In fact, minimal hiring in our client base experienced over the first half of 2023 turned into a low level of net reductions in the latter half. This contributed to paid worksite employee growth in Q4 of 2.5%, slightly below the low end of our forecasted range. In a few minutes, Paul and I will comment further on the outcome of our recent sales campaign and heavy client renewal period leading to our 2024 growth outlook.

Fourth quarter gross profit exceeded our expectations on higher pricing and lower benefit costs and payroll taxes. The Q4 year over year comparison represents a decline in gross profit due to unusually low benefit costs in Q4 of 2022. Operating expenses increased 5% over Q4 of the prior year, in line with our forecast, and included a planned increase in Business Performance Advisors and service personnel, and continued investment in our technology.

Net interest income was consistent with the prior year. Our Q4 effective income tax rate came in at 19% and was favorably impacted by lower state taxes and R&D tax credits.

FULL YEAR 2023 RESULTS

Now, let me recap our full year 2023 results. We earned \$354 million of Adjusted EBITDA and adjusted EPS of \$5.52.

As for the drivers:

We achieved 6% growth in average paid worksite employees despite the significant decline in net hiring in our client base due to macro-economic headwinds. These same headwinds contributed to slight declines in (1) client retention to an annual rate of 83% and (2) worksite employees paid from new sales.

Gross profit per worksite employee per month, our key pricing and direct cost metric, was \$277 in 2023, just slightly below our budget despite elevated healthcare costs incurred in Q2. These results demonstrated our ability to effectively execute our pricing strategy, while managing our direct cost areas over the full year.

Operating expenses increased 7.5% over 2022 and included key investments in our long-term growth plan. In addition to a 12% increase in the number of Business Performance Advisors, we increased our service capacity and continued to invest in our technology, including the implementation of Salesforce across both our sales and service organizations. The current inflationary environment drove higher compensation of our corporate employees and other operating expenses, such as travel costs.

We continued to produce strong cash flow and ended the year with a solid balance sheet, while continuing to invest in the business, and providing strong returns to our shareholders. We invested \$40 million in capital expenditures in 2023 and returned \$216 million to stockholders through dividends and our share repurchase programs. We repurchased a total of 1.3 million shares at a cost of \$132 million. We also paid out \$84 million in cash dividends, which included a 10% increase in our regular dividend rate in May of 2023. We ended 2023 with \$171 million of adjusted cash and continue to have \$370 million outstanding 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 is a pivotal day in the thirty-eight-year history of Insperity with the announcement of our exclusive strategic partnership with Workday. In my view, this could be a game changer in the marketplace and at the same time, significantly elevate the potential trajectory of our company driving long-term growth, profitability, and value creation for Insperity.

The focus of my comments today will be to explain the nature of this agreement, including how and why I believe this is so monumental. I will also provide context around how this new relationship plays into our long-term strategy and our outlook for 2024 based upon our 2023 performance and the business economic environment.

Let's begin with the nature of this strategic partnership and why it has the potential to be so significant for Insperity and Workday, and most importantly small and midsize companies in the marketplace.

Through this strategic partnership, Workday and Insperity are committed to jointly developing, marketing, selling, and supporting the preeminent solution for targeted small and medium-sized businesses that combines Workday's HR technology with Insperity's HR services into a new exclusive Insperity PEO offering.

We expect to offer this unique combined solution to the target market for significantly less upfront capital cost, ongoing expense, complexity, and implementation time than currently available to those businesses. By addressing these issues, we believe this new solution has the potential to be competitively disruptive.

We believe that our joint solution will provide the target market of growing small and mid-size businesses with as few as 100 employees with a new scalable capability with the potential to greatly enhance their likelihood, degree, and speed of success.

The complementary strengths of both firms directed toward this target market creates a powerful opportunity. Historically, Workday disrupted the marketplace by providing a best-in-class HCM technology solution and began at the high end of the market targeting the Fortune 500. They have been tremendously successful, and we believe they are the industry leader and premium brand in their space.

As Workday has expanded down market, the reality is the smaller the company the more they need HR services to implement and get the full value from their solution and be successful. This is where we believe Insperity is an excellent fit for Workday.

Insperity disrupted the marketplace by providing a best-in-class HR services solution and began at the other end of the market serving companies with as few as 10 employees. We have also been tremendously successful, and we believe we are the industry leader and the premium brand in our space.

As Insperity has expanded up market, the reality is the larger the company the more they need more sophisticated technology to get the full value from our solution and be successful. This is where we believe Workday is an excellent fit for Insperity.

Over our history we have built a deeply integrated and highly effective system to manage a PEO and comply with the unique legislative, regulatory, and industry specific requirements. We have historically used our proprietary HR technology platform for all our clients from the smallest to the largest.

The process over the last couple of months evaluating the feasibility of developing this new solution highlighted the sophistication and quality of our own Insperity PEO/HCM platform. We intend to continue using this platform for our smaller clients and those that are otherwise not ready for this new joint solution.

So, Insperity and Workday are becoming strategic partners focused on three major objectives. First, we will be developing and embedding an instance of Workday as the client facing HR technology within our Workforce Optimization offering to create the new joint solution for the target market.

Second, we are establishing a deployment and enablement team within the Insperity service organization with the help of Workday. We believe our speed of implementation for our PEO clients distinguishes us compared to the HCM space. Our goal for this team is to provide implementations and support for the new solution in a similar efficient and effective manner as we do today.

Third we are initiating a go to market strategic plan for Insperity and Workday to address this target market including co-branding, co-marketing, and co-selling. We believe there are opportunities for each company to benefit from these aspects of our strategic partnership even before the new solution is launched.

Now, let me focus on how and why this strategic partnership could be such a game changer for Insperity. This partnership has the potential to dramatically improve all three of our most significant drivers of our financial model; new sales, client retention, and pricing our services.

Importantly, this is an exclusive agreement with Workday within the PEO industry. The exclusivity extends for at least five years following the launch of the joint solution. I believe this provides Insperity with a significant new competitive advantage and influences all three of these key drivers of our business.

I believe the effect on sales can begin immediately primarily due to a significant step up in leads we expect through an automated process and the ultimate potential for prospects to upgrade to Workday HCM once the new solution is launched.

Workday currently makes a substantial marketing investment to attract potential customers interested in improving their HR technology. Their successful marketing programs generate a substantial number of qualified leads for their target market of larger firms, but as is typical in significant marketing programs, they generate thousands of leads from prospects outside of their primary target including smaller firms.

We believe these leads that do not meet Workday's criteria for direct sales due to the size of the prospects are in the heart of our target market and are similar to the leads we generate with our own marketing spend.

This means that Workday can optimize their marketing spend by passing these leads off to Insperity creating a pipeline for potential new business for Workday in the future.

Our initial high-level view into these potential referrals indicates the possibility of increasing the number of qualified leads substantially beyond the level we generate with our own marketing efforts. We believe this could considerably increase the sales activity for our more than 750 Business Performance Advisors.

Another important aspect of this strategic partnership is focused on helping customers select the right solution to help them succeed. Insperity will reciprocate referring the larger prospects to Workday that fit their solution best at the time we first interact with them in our sales process, or once a current client's needs are beyond our solution.

Ultimately the second potential driver for sales would be the new solution once launched with the full force of the strategic partnership go-to-market plan. However, we also anticipate prioritizing current clients upgrading to the new solution. Therefore, coming on our current Workforce Optimization service now is a step to get in line for being on Workday more efficiently and cost effectively once our new solution is available.

The second driver to our financial model that we believe will be enhanced by this strategic partnership is client retention. The Workday features and functionality in this new jointly developed solution could significantly influence client retention of our largest accounts. Historically, we have considered losing large accounts we helped grow significantly as our success penalty.

Many times, we have brought small companies on our Workforce Optimization solution and helped them grow from 20 or 30 employees to a thousand or more on their way to being highly successful firms. Examples of this are Hello Fresh, Netflix and, believe it or not, Workday!

When a client grows to this level and they terminate the relationship, we could need 50 or more of our typical new small business clients to replace them. We experienced this success penalty to a degree this year which I will discuss in a few minutes.

We expect the new solution will better position us to meet the needs of our larger clients, which we believe will allow us to retain these clients for a longer period that is more in line with Workday's exceptional retention track record.

We anticipate in the future when we ultimately graduate a current client on the new solution to their own instance of Workday, our new enablement and implementation team may also facilitate the transition and provide ongoing support, and Insperity may even continue to provide other HR solutions.

So, we believe our customer for life strategy will be enhanced by this strategic partnership by providing a solution that should reduce large client terminations, and better position us to capitalize on our historical success penalty in the future by continuing to provide services even after a client leaves our Workforce Optimization solution.

Now, in addition to a potential improvement in new sales and client retention, I believe this strategic partnership may have a meaningful effect on our third key driver to our business model, pricing our services.

The ability to increase pricing to match the enhanced value of the new solution is a significant opportunity, as our prospects often compare their own future expected costs as an employer to our comprehensive service fee to make their buying decision.

We have identified several potential improvements in this area made possible by this new strategic partnership, however they are preliminary and proprietary so I will not go into detail today.

So, the power of this strategic partnership with Workday for Insperity is the long-term potential to significantly drive three of our most important key success factors; new sales, client retention, and pricing.

Now both companies are investing in our strategic partnership. I would like to explain the Insperity investment necessary to launch this partnership and create this new PEO solution combining Workday HCM technology with Insperity Workforce Optimization services.

Our new investment is currently expected to be approximately \$150 million dollars over a five-year period more heavily weighted in the first two years.

The investment includes Workday subscriptions for a certain number of worksite employees on this new solution over the term of the contract, significant development to create the solution, staffing and training a new deployment and enablement organization, and funding a go to market strategy ramping up sales, and sales support staff.

The investment also includes Insperity becoming a Workday customer for our corporate staff which is ideal for our 4,300-employee company with dynamic future growth. We believe it is an important foundational step to have our entire staff on Workday to be ready to support our clients as we launch our new solution.

We expect this investment will cause a drag on adjusted EBITDA and earnings per share for a couple of years, however we believe the potential to capitalize on the opportunity to elevate the trajectory for long-term growth and profitability in the future is significant.

I personally weighed this decision heavily with the appropriate level of consideration. As I sit here today as Chairman, CEO, co-founder, and a significant shareholder of Insperity, I am convinced this is the right decision.

For the next couple of years adjusted EBITDA and earnings per share may not be the most important measures as they have been in the past. The progress and milestones achieved in developing, launching, and implementing our strategic partnership with Workday will be important measures as well.

Now, let me also put this decision into context with our 2023 results and our outlook for 2024. We had a solid year last year in a more difficult economic climate in the small business community.

This was reflected most noticeably in the net change in employment within our client base slowing from a solid net gain in the first half of the year to net reductions over the last half and into January.

Another factor that weighs into our starting point for paid worksite employees as we move into 2024 is the year end transition including client retention from our heavy renewal period. Our retention was strong, except for our mid-market client attrition, which included our success penalty on seven of our large accounts.

This economic backdrop in our target market also effected decision making in the sales process, which was most apparent in the third quarter. We reacted well to this dynamic and had significantly stronger fourth quarter booked sales. The full year was not as strong in our core Business Performance Advisor sales as we had originally expected, however we exceeded our target in mid-market sales.

After a thorough evaluation of last year, there are two areas that we believe would have made the year significantly stronger even in a tougher environment. The first one is the number of leads to produce more sales opportunities, which is frequently the answer for new sales in a more difficult economic environment.

The second area that we believe would make a significant difference is a systemic change that would address our success penalty related to retention of our larger accounts.

The new strategic partnership with Workday is timely due to the potential to provide a step up in the volume of sales opportunities and improve large account retention substantially beyond a level we could achieve on our own.

Even without the new partnership, we believe our progress last year including growing the sales organization, validating new marketing efforts, and staffing up our service team positions the company well for growth acceleration over the coming year.

One last point I would like to make relative to this significant investment decision is our historical use of capital commitment that has provided an exceptional return to shareholders.

Over the last ten years, our significant growth combined with our highly capital efficient business model generated sufficient cash to allow us to repurchase approximately 20 million shares for just under one billion dollars. As Doug mentioned, last year alone we repurchased 1.3 million shares at a cost of \$132 million dollars.

Making this investment of an estimated \$150 million dollars in this context does not represent any change in our prioritization of return to shareholders, rather it represents our view of the opportunity to significantly increase returns over the long-term.

I would like to thank the Insperity and Workday teams that made this strategic partnership happen. The ability of our two teams to evaluate the opportunity and

expediently and effectively reach agreement on the strategic partnership is evidence of the aligned corporate culture connection between the two firms.

This adds to my confidence in the strategic partnership delivering this solution with the potential to greatly enhance the likelihood, degree, and speed of success for this target market.

I also believe these two powerful brands have made a commitment to work together strategically enhancing the likelihood, degree, and speed of success for this dynamic Workday/Insperity strategic partnership.

This investment represents an incredible opportunity to elevate the long-term trajectory for growth, profitability, and value creation for Insperity and our ultimate return to shareholders into the future.

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

Doug Sharp

Thanks, Paul.

2024 GUIDANCE

Thanks, Paul.

Before I provide the specifics behind our 2024 guidance, be aware that this guidance reflects both the expected performance of our core operations, as well as our estimated costs associated with the Workday strategic partnership. As Paul mentioned, over the course of 2024, we will be performing significant development work to offer a preeminent technology and service solution to our MidMarket clients. Most costs associated with these development efforts will be reflected as expense and therefore not capitalized. This will obviously have a significant impact on our forecasted 2024 earnings. As we collaborate with Workday through the first quarter to further solidify the scope of the effort for the strategic partnership, our preliminary estimates of the costs that we used for this guidance may be revised. Any impact of the partnership on revenues in 2024 would primarily be related to the lead flow for our workforce optimization sales in the back half of the year.

Worksite Employee Growth

Now as for the details of our guidance, our worksite employee growth is largely dictated by our January 2024 starting point. As Paul just mentioned, our client retention rate was similar to 2023 during our heavy client renewal period, excluding the impact of a small number of large accounts. Additionally, the current macro-economic factors and general uncertainty in the marketplace led to our client base experiencing net reductions in employees over the second half of 2023, continuing into January of 2024. These two factors were the primary contributors to a lower starting point going into the year and reduced our full year 2024 growth rate by about 4%, which is about \$40 million in gross

profit. As for the remainder of the year, we are assuming gradual improvement and more certainty in the macro-economic environment. When combined with higher average tenure of our BPAs and an expected increase in lead flow, we are budgeting for an improvement in sales efficiency over the course of 2024. We continue to expect minimal hiring by our clients when compared to historical levels.

So, when considering these factors, we are forecasting worksite employee growth for Q1 of 2024 to be in a range of a 1% decline to flat and expect growth of 2% to 3% for the full year. This guidance assumes expected sequential improvement over the course of 2024, with our forecast ending the year with a paid worksite employee count that is 8% higher than December 2023.

Gross Profit

As for gross profit, we have considered the pricing achieved over 2023 and during our recent sales and client renewal period. We intend to continue to focus on pricing given the expected impact of an ongoing inflationary environment on both our direct costs, including healthcare costs, and our operating expenses. We expect a generally stable environment in our payroll tax and workers' compensation areas. As for the benefits component of our direct costs, we anticipate a cost trend of 4.5% to 6%. We exited 2023 with our pricing allocations and direct cost trends aligned, and our 2024 plan is based on matching or exceeding expected changes in our direct costs. When considering these factors, we expect the full year and Q1 2024 gross profit per worksite employee to be similar to that achieved in the 2023 periods. Subsequent to Q1, we expect this metric to step down in each of the following three quarters as payroll tax wages and benefit plan deductibles are met.

Operating Costs

Now, our budgeted operating expenses include costs associated with both our core operations and the Workday strategic partnership. We are roughly estimating that costs related to the partnership will be in the ballpark of \$60 million in 2024, primarily in the back half of the year when including the incremental costs that Paul just mentioned, plus our internal redeployed resources.

As for our core operations, our budgeted 2024 operating costs include the full year impact of successfully hiring sales, service and support personnel in 2023, coming off of the 18% worksite employee growth in 2022. This puts us in a position for minimal hiring in our core operation in 2024, including the hiring of fewer Business Performance Advisors. We are forecasting to end the year with a 6% increase in Business Performance Advisors over 2023, to just over 800.

Interest Rates and Tax Rate

As for our interest income and expense, our 2024 budget assumes the current interest rates and a run rate slightly above 2023. We are estimating a tax rate of 26% for Q1 and the full year 2024.

Full Year 2024 Earnings Guidance

So, after putting together all of the pieces, including our current estimates of costs associated with the Workday partnership, we are forecasting 2024 Adjusted EBITDA in a range of \$241 million to \$285 million. The midpoint of this range is about \$90 million below the prior year, of which approximately \$60 million is related to the partnership with Workday. The remainder is primarily related to the lower starting point in paid worksite employees. We are forecasting a full year Adjusted EPS in a range of \$3.02 to \$3.88.

With the strategic partnership development work kicking off in the first quarter, we are forecasting Q1 Adjusted EBITDA in a range of \$121 million to \$137 million, and Adjusted EPS in a range of \$1.94 to \$2.24.

Now, before we open up the call for questions, we'd like to announce our intentions to hold an Investor and Analyst Day in the second half of May this year to further discuss our exciting strategic partnership with Workday and how it fits into our long-term plans. We will announce the specific date at a later time.