

INSPERITY, INC.  
Form 10-Q  
November 01, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934

For the quarterly period ended September 30, 2012.

or  
 Transition Report Pursuant to Section 13 or 15(d) of the Securities  
Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-13998

Insperty, Inc.  
(Exact name of registrant as specified in its charter)

Delaware 76-0479645  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

19001 Crescent Springs Drive  
Kingwood, Texas 77339  
(Address of principal executive offices) (Zip Code)

(Registrant's Telephone Number, Including Area Code): (281) 358-8986

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 25, 2012, 25,654,217 shares of the registrant's common stock, par value \$0.01 per share, were outstanding.

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

INSPERITY, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands)

## ASSETS

	September 30, 2012 (Unaudited)	December 31, 2011
Current assets:		
Cash and cash equivalents	\$ 202,218	\$ 211,208
Restricted cash	46,069	44,737
Marketable securities	51,702	56,987
Accounts receivable, net:		
Trade	2,255	7,893
Unbilled	198,197	158,508
Other	2,656	4,532
Prepaid insurance	23,739	21,300
Other current assets	8,133	11,488
Income taxes receivable	—	2,902
Deferred income taxes	940	3,233
Total current assets	535,909	522,788
Property and equipment:		
Land	3,653	3,653
Buildings and improvements	69,868	67,496
Computer hardware and software	78,836	76,105
Software development costs	35,431	32,699
Furniture and fixtures	36,595	36,133
Aircraft	35,879	35,866
	260,262	251,952
Accumulated depreciation and amortization	(167,335 )	(159,008 )
Total property and equipment, net	92,927	92,944
Other assets:		
Prepaid health insurance	9,000	9,000
Deposits – health insurance	3,000	2,640
Deposits – workers’ compensation	57,588	52,320
Goodwill and other intangible assets, net	27,131	28,433
Other assets	4,879	4,134
Total other assets	101,598	96,527
Total assets	\$ 730,434	\$ 712,259



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INSPERITY, INC.  
CONSOLIDATED BALANCE SHEETS (Continued)  
(in thousands)

## LIABILITIES AND STOCKHOLDERS' EQUITY

	September 30, 2012 (Unaudited)	December 31, 2011
Current liabilities:		
Accounts payable	\$ 3,088	\$ 5,085
Payroll taxes and other payroll deductions payable	107,932	168,652
Accrued worksite employee payroll cost	174,264	130,317
Accrued health insurance costs	22,522	9,427
Accrued workers' compensation costs	48,369	46,548
Accrued corporate payroll and commissions	21,819	22,383
Other accrued liabilities	13,975	13,814
Income taxes payable	3,987	—
Total current liabilities	395,956	396,226
Noncurrent liabilities:		
Accrued workers' compensation costs	63,463	60,054
Deferred income taxes	10,768	10,772
Total noncurrent liabilities	74,231	70,826
Commitments and contingencies		
Stockholders' equity:		
Common stock	309	309
Additional paid-in capital	136,688	135,871
Treasury stock, at cost	(138,784 )	(134,647 )
Accumulated other comprehensive income, net of tax	70	24
Retained earnings	261,964	243,650
Total stockholders' equity	260,247	245,207
Total liabilities and stockholders' equity	\$ 730,434	\$ 712,259

See accompanying notes.

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INSPERITY, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share amounts)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues (gross billings of \$3.068 billion, \$2.835 billion, \$9.339 billion and \$8.454 billion, less worksite employee payroll cost of \$2.556 billion, \$2.363 billion, \$7.712 billion and \$6.973 billion, respectively)	\$ 511,953	\$ 471,821	\$ 1,626,386	\$ 1,481,105
Direct costs:				
Payroll taxes, benefits and workers' compensation costs	413,533	384,792	1,337,668	1,219,276
Gross profit	98,420	87,029	288,718	261,829
Operating expenses:				
Salaries, wages and payroll taxes	44,032	39,494	127,402	117,558
Stock-based compensation	2,429	2,109	7,385	6,455
Commissions	3,358	3,399	10,299	9,750
Advertising	3,680	5,235	17,001	18,280
General and administrative expenses	21,122	18,912	61,694	57,828
Depreciation and amortization	4,659	3,786	13,336	11,335
	79,280	72,935	237,117	221,206
Operating income	19,140	14,094	51,601	40,623
Other income (expense):				
Interest, net	142	245	462	829
Other, net	(3 )	(7,501 )	141	(7,497 )
	139	(7,256 )	603	(6,668 )
Income before income tax expense	19,279	6,838	52,204	33,955
Income tax expense	7,827	2,739	21,247	14,329
Net income	\$11,452	\$4,099	\$30,957	\$19,626
Less net income allocated to participating securities	(334 )	(120 )	(898 )	(582 )
Net income allocated to common shares	\$11,118	\$3,979	\$30,059	\$19,044
Basic net income per share of common stock	\$0.45	\$0.16	\$1.20	\$0.75
Diluted net income per share of common stock	\$0.45	\$0.16	\$1.20	\$0.74

See accompanying notes.

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INSPERITY, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (in thousands)  
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$11,452	\$4,099	\$30,957	\$19,626
Other comprehensive income:				
Unrealized gain (loss) on available-for-sale securities, net of tax	12	(7 )	46	31
Comprehensive income	\$11,464	\$4,092	\$31,003	\$19,657

See accompanying notes.



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INSPERITY, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
NINE MONTHS ENDED SEPTEMBER 30, 2012  
(in thousands)  
(Unaudited)

	Common Stock Issued		Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount	Capital	Stock	(Loss)	Earnings	Total
Balance at December 31, 2011	30,839	\$ 309	\$ 135,871	\$ (134,647)	\$ 24	\$ 243,650	\$ 245,207
Purchase of treasury stock, at cost				(13,770 )	—		(13,770 )
Exercise of stock options			(558 )	1,620	—		1,062
Income tax benefit from stock-based compensation, net			1,097	—	—		1,097
Stock-based compensation expense	—	—	199	7,186	—	—	7,385
Other			79	827	—		906
Dividends paid	—	—	—	—	—	(12,643 )	(12,643 )
Unrealized gain on marketable securities, net of tax	—	—	—	—	46	—	46
Net income	—	—	—	—	—	30,957	30,957
Balance at September 30, 2012	30,839	\$ 309	\$ 136,688	\$ (138,784)	\$ 70	\$ 261,964	\$ 260,247

See accompanying notes.

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INSPERITY, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$30,957	\$19,626
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,336	11,335
Loss on exchange of assets	(21 )	4,396
Amortization of marketable securities	1,827	1,535
Stock-based compensation	7,385	6,455
Deferred income taxes	2,259	(96 )
Changes in operating assets and liabilities, net of effects from acquisitions:		
Restricted cash	(1,332 )	(1,608 )
Accounts receivable	(32,175 )	(20,231 )
Prepaid insurance	(2,439 )	9,796
Other current assets	3,355	(2,339 )
Other assets	(6,373 )	4,876
Accounts payable	(1,997 )	(650 )
Payroll taxes and other payroll deductions payable	(60,704 )	(40,892 )
Accrued worksite employee payroll expense	43,947	21,091
Accrued health insurance costs	13,095	(10,210 )
Accrued workers' compensation costs	5,231	6,013
Accrued corporate payroll, commissions and other accrued liabilities	2,155	3,656
Income taxes payable/receivable	6,529	479
Total adjustments	(5,922 )	(6,394 )
Net cash provided by operating activities	25,035	13,232
Cash flows from investing activities:		
Marketable securities purchases	(23,585 )	(43,607 )
Marketable securities proceeds from dispositions	—	3,907
Marketable securities proceeds from maturities	27,119	26,194
Cash exchanged for acquisitions	(1,200 )	(13,125 )
Property and equipment	(11,996 )	(23,404 )
Net cash used in investing activities	(9,662 )	(50,035 )

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INSPERITY, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)  
(in thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from financing activities:		
Purchase of treasury stock	\$(13,770 )	\$(22,459 )
Dividends paid	(12,643 )	(11,871 )
Proceeds from the exercise of stock options	1,062	3,881
Income tax benefit from stock-based compensation	1,457	2,049
Other	(469 )	284
Net cash used in financing activities	(24,363 )	(28,116 )
Net decrease in cash and cash equivalents	(8,990 )	(64,919 )
Cash and cash equivalents at beginning of period	211,208	234,829
Cash and cash equivalents at end of period	\$202,218	\$169,910

## Supplemental Cash Flow Information:

In September 2011, the Company exchanged an existing aircraft with a fair value of \$4.0 million and paid an additional \$10.0 million to acquire a replacement aircraft, resulting in a non-cash loss of \$4.4 million, which is included in other income (expense).

See accompanying notes.

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INSPERITY, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2012  
(Unaudited)

1. Basis of Presentation

Insperty, Inc., a Delaware corporation (“Insperty,” “we,” “our,” and “us”), provides an array of human resources (“HR”) and business solutions designed to help improve business performance. Our most comprehensive HR business offering is provided through our professional employer organization (“PEO”) services, known as Workforce Optimization™, which encompasses a broad range of HR functions, including payroll and employment administration, employee benefits, workers’ compensation, government compliance, performance management, and training and development services.

In addition to Workforce Optimization, we offer Human Capital Management, Payroll Services, Time and Attendance, Performance Management, Organizational Planning, Recruiting Services, Employment Screening, Financial Services, Expense Management, Retirement Services and Insurance Services (collectively “Adjacent Businesses”), many of which are offered via desktop applications and software as a service (“SaaS”) delivery models. These other products or services are offered separately, as a bundle, or along with Workforce Optimization (“Bundle Plus”).

We provide our Workforce Optimization solution to small and medium-sized businesses in strategically selected markets throughout the United States. For the nine months ended September 30, 2012 and 2011, Workforce Optimization revenues from Insperty’s Texas markets represented 26% and 27%, while Workforce Optimization revenues from Insperty’s California markets represented 17% and 16%, of Insperty’s total Workforce Optimization revenues, respectively.

The Consolidated Financial Statements include the accounts of Insperty and its subsidiaries, all of which are wholly owned. Intercompany accounts and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The accompanying Consolidated Financial Statements should be read in conjunction with our audited Consolidated Financial Statements as of and for the year ended December 31, 2011. Our Consolidated Balance Sheet at December 31, 2011 has been derived from the audited financial statements at that date, but does not include all of the information or footnotes required by GAAP for complete financial statements. Our Consolidated Balance Sheet at September 30, 2012 and the Consolidated Statements of Operations and Comprehensive Income for the three and nine month periods ended September 30, 2012 and 2011, the Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2012 and 2011, and Consolidated Statement of Stockholders’ Equity for the nine month period ended September 30, 2012, have been prepared by us without audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows, have been made.

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The results of operations for the interim periods are not necessarily indicative of the operating results for a full year or of future operations.

2. Accounting Policies

Health Insurance Costs

We provide group health insurance coverage to our worksite employees through a national network of carriers, including UnitedHealthcare (“United”), Kaiser Permanente, Blue Shield of California, HMS BlueCross BlueShield, Unity Health Plan and Tufts, all of which provide fully insured policies or service contracts.

The policy with United provides the majority of our health insurance coverage. As a result of certain contractual terms, Insuperity has accounted for this plan since its inception using a partially self-funded insurance accounting model. Accordingly, Insuperity records the costs of the United plan, including an estimate of the incurred claims, taxes and administrative fees (collectively the “Plan Costs”) as benefits expense in the Consolidated Statements of Operations. The estimated incurred claims are based upon: (i) the level of claims processed during the quarter; (ii) estimated completion rates based upon recent claim development patterns under the plan; and (iii) the number of participants in the plan, including both active and COBRA enrollees. Each reporting period, changes in the estimated ultimate costs resulting from claim trends, plan design and migration, participant demographics and other factors are incorporated into the benefits costs.

Additionally, since the plan’s inception, under the terms of the contract, United establishes cash funding rates 90 days in advance of the beginning of a reporting quarter. If the Plan Costs for a reporting quarter are greater than the premiums paid and owed to United, a deficit in the plan would be incurred and a liability for the excess costs would be accrued in our Consolidated Balance Sheets. On the other hand, if the Plan Costs for the reporting quarter are less than the premiums paid and owed to United, a surplus in the plan would be incurred and we would record an asset for the excess premiums in our Consolidated Balance Sheets. The terms of the arrangement require Insuperity to maintain an accumulated cash surplus in the plan of \$9.0 million, which is reported as long-term prepaid insurance. In addition, United requires a deposit equal to approximately one day of claims funding activity, which was \$2.8 million as of September 30, 2012, and is reported as a long-term asset. As of September 30, 2012, Plan Costs were less than the net premiums paid and owed to United by \$30.2 million. As this amount is in excess of the agreed-upon \$9.0 million surplus maintenance level, the \$21.2 million balance is included in prepaid insurance, a current asset, in our Consolidated Balance Sheets. The premiums owed to United at September 30, 2012 were \$19.2 million, which is included in accrued health insurance costs, a current liability in our Consolidated Balance Sheets.

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Workers' Compensation Costs

Insperty's workers' compensation coverage has been provided through an arrangement with the ACE Group of Companies ("the ACE Program") since 2007. The ACE Program is fully insured in that ACE has the responsibility to pay all claims incurred regardless of whether Insperty satisfies its responsibilities. Through September 30, 2010, Insperty bore the economic burden for the first \$1 million layer of claims per occurrence and the insurance carrier was and remains responsible for the economic burden for all claims in excess of such first \$1 million layer.

Effective October 1, 2010, in addition to our bearing the economic burden for the first \$1 million layer of claims per occurrence, we also bear the economic burden for those claims exceeding \$1 million, up to a maximum aggregate amount of \$5 million per policy year.

Because we bear the economic burden for claims up to the levels noted above, such claims, which are the primary component of our workers' compensation costs, are recorded in the period incurred. Workers' compensation insurance includes ongoing health care and indemnity coverage whereby claims are paid over numerous years following the date of injury. Accordingly, the accrual of related incurred costs in each reporting period includes estimates, which take into account the ongoing development of claims and therefore requires a significant level of judgment.

Insperty employs a third party actuary to estimate its loss development rate, which is primarily based upon the nature of worksite employees' job responsibilities, the location of worksite employees, the historical frequency and severity of workers' compensation claims, and an estimate of future cost trends. Each reporting period, changes in the actuarial assumptions resulting from changes in actual claims experience and other trends are incorporated into our workers' compensation claims cost estimates. During the nine months ended September 30, 2012 and 2011, Insperty reduced accrued workers' compensation costs by \$10.4 million and \$8.6 million, respectively, for changes in estimated losses related to prior reporting periods. Workers' compensation cost estimates are discounted to present value at a rate based upon the U.S. Treasury rates that correspond with the weighted average estimated claim payout period (the average discount rates utilized in 2012 and 2011 were 0.7% and 1.2%, respectively) and are accreted over the estimated claim payment period and included as a component of direct costs in our Consolidated Statements of Operations.

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The following table provides the activity and balances related to incurred but not paid workers' compensation claims:

	Nine Months Ended September 30,	
	2012	2011
	(in thousands)	
Beginning balance, January 1,	\$ 104,791	\$ 96,934
Accrued claims	28,586	26,668
Present value discount	(712 )	(1,159 )
Paid claims	(23,133 )	(21,123 )
Ending balance	\$ 109,532	\$ 101,320
Current portion of accrued claims	\$ 46,069	\$ 42,812
Long-term portion of accrued claims	63,463	58,508
	\$ 109,532	\$ 101,320

The current portion of accrued workers' compensation costs on the Consolidated Balance Sheets at September 30, 2012 includes \$2.3 million of workers' compensation administrative fees.

As of September 30, 2012 and 2011, the undiscounted accrued workers' compensation costs were \$121.7 million and \$115.1 million, respectively.

At the beginning of each policy period, the insurance carrier establishes monthly funding requirements comprised of premium costs and funds to be set aside for payment of future claims ("claim funds"). The level of claim funds is primarily based upon anticipated worksite employee payroll levels and expected workers' compensation loss rates, as determined by the insurance carrier. Monies funded into the program for incurred claims expected to be paid within one year are recorded as restricted cash, a short-term asset, while the remainder of claim funds are included in deposits, a long-term asset in our Consolidated Balance Sheets. In the first nine months of 2012 and 2011, we received \$2.5 million and \$10.0 million, respectively, for the return of excess claim funds related to the ACE Program, which reduced deposits. As of September 30, 2012, we had restricted cash of \$46.1 million and deposits of \$57.6 million.

Insperty's estimate of incurred claim costs expected to be paid within one year are recorded as accrued workers' compensation costs and included in short-term liabilities, while its estimate of incurred claim costs expected to be paid beyond one year are included in long-term liabilities on our Consolidated Balance Sheets.

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## 3. Cash, Cash Equivalents and Marketable Securities

The following table summarizes our cash and investments in cash equivalents and marketable securities held by investment managers and overnight investments:

	September 30, 2012 (in thousands)	December 31, 2011
Overnight Holdings		
Money market funds (cash equivalents)	\$46,079	\$ 71,350
Investment Holdings		
Money market funds (cash equivalents)	67,395	59,587
Marketable securities	51,702	56,987
	165,176	187,924
Cash held in demand accounts	102,761	113,968
Outstanding checks	(14,017 )	(33,697 )
Total cash, cash equivalents and marketable securities	\$253,920	\$ 268,195
Cash and cash equivalents	\$202,218	\$ 211,208
Marketable securities	51,702	56,987
	\$253,920	\$ 268,195

Our cash and overnight holdings fluctuate based on the timing of the client's payroll processing cycle. Included in the cash balance as of September 30, 2012 and December 31, 2011, are \$96.5 million and \$150.8 million, respectively, in funds associated with federal and state income tax withholdings, employment taxes and other payroll deductions, as well as \$12.4 million and \$10.4 million in client prepayments, respectively.

Insperty accounts for its financial assets in accordance with Accounting Standard Codification ("ASC") 820, Fair Value Measurement. This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The fair value measurement disclosures are grouped into three levels based on valuation factors:

- Level 1 - quoted prices in active markets using identical assets
- Level 2 - significant other observable inputs, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other observable inputs
  - Level 3 - significant unobservable inputs



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The following table summarizes the levels of fair value measurements of our financial assets:

	Fair Value Measurements (in thousands) September 30, 2012			
		Level 1	Level 2	Level 3
Money market funds	\$ 113,474	\$ 113,474	\$ —	\$ —
Municipal bonds	51,702	—	51,702	—
Total	\$ 165,176	\$ 113,474	\$ 51,702	\$ —

	Fair Value Measurements (in thousands) December 31, 2011			
		Level 1	Level 2	Level 3
Money market funds		\$130,937	\$—	\$—
Municipal bonds		56,987	56,987	—
Total		\$187,924	\$56,987	\$—

The municipal bond securities valued as Level 2 investments are primarily pre-refunded municipal bonds that are secured by escrow funds containing U.S. Government securities. Valuation techniques used by Insperity to measure fair value for these securities during the period consisted primarily of third party pricing services that utilized actual market data such as trades of comparable bond issues, broker/dealer quotations for the same or similar investments in active markets and other observable inputs.

The following is a summary of our available-for-sale marketable securities:

	Gross	Gross
Amortized		