Letter to Shareholders

Administaff experienced an extraordinary recovery and return to profitability in 2003. While emerging from one of the most challenging periods in our 17-year history, we overcame significant obstacles, accomplished major objectives and posted some of our best-ever financial results. We also set the stage for a return to double-digit unit growth by year-end 2004.

Leading Administaff's financial performance in 2003 was record-setting operating income of $24.3 million, compared to $67,000 in 2002. With this accomplishment, we successfully transitioned from our worst year, to our best year, in one year. The Company also achieved $27 in operating income per worksite employee per month, which is at the upper end of our historical range. Driving home the magnitude of our recovery was a 36 percent increase in working capital to a record $56.0 million.

Revenues for the year increased 5.1 percent to $892 million, primarily due to an 8.3 percent increase in monthly revenues per worksite employee. Although our worksite employee base decreased 3.0 percent, our monthly gross profit per worksite employee rose 22.9 percent, primarily as a result of improved pricing and effective management of direct costs. The Company also posted net income and diluted net earnings per share from continuing operations of $15.0 million and $0.55, versus a net loss of $2.9 million and diluted net loss per share of $0.11 in 2002.

In addition to our financial results for 2003, we made tremendous strides to strengthen our Company and our product proposition by enhancing our service model, improving processes, and settling legal and regulatory matters:

Launch of Administaff Retirement Services. As a result of 2002's Internal Revenue Service Guidance, we were able to expand our retirement savings offering for clients and plan participants in 2003. In October, Administaff became the recordkeeper for its existing 401(k) plan, then transitioned nearly 3,000 client companies to the new Administaff Retirement Services plans. This expanded offering provides participants with more investment options and greater plan flexibility. As a result, we expect to attract and retain more clients and to benefit from those who may use our retirement services outside of the co-employment relationship.

Paul J. Sarvadi
Chairman and
Chief Executive Officer

Advances in client service. To help increase client retention, we continued to refine our team-based service model to help ensure every client receives top-notch service from its team of specialists. We also aligned the compensation of our service providers with annual retention targets. A 2003 client survey revealed a higher level of overall satisfaction with Administaff than in 2002. Ninety-two percent of respondents said they are "completely or mostly" satisfied with the professionalism of our staff, and 95 percent indicated an intention to renew with Administaff in 2004.

New benefits and services. Enhancing our eBusiness initiative was the introduction of an improved online training program and AVA, a virtual assistant that uses conversational language to answer worksite employees' basic questions about Administaff benefits and services. We also launched a new commuter benefit that allows worksite employees to designate pretax dollars to pay for eligible commuting expenses, such as work-related mass transit and parking.

Matching price with cost. The conversion of new and renewing clients to our real-time pricing and billing system was completed in 2003. The new system eliminates the potential for revenue shortfall resulting from changes in pay rates or benefit elections of worksite employees. We also reorganized our management team to better align the Company's resources with our goals for matching price with cost.

Improvements to direct cost items. By managing and controlling our direct costs more effectively, we have increased our competitive edge in several key areas:

• **Health care benefits cost** – Administaff's security deposit with UnitedHealthcare, our primary health insurance carrier, was reduced from $25.0 million to $17.5 million, with $7.5 million of the original deposit refunded in early 2004. By incorporating risk factors such as age, gender and COBRA ratings into our pricing model, we improved alignment between client pricing allocation and the marketplace. To improve client selection and control plan costs, we tightened our risk management standards, including client size, employer contributions and COBRA takeovers. In addition, the increased use of technology and a streamlining of administrative processes between the companies resulted in a reduction of UnitedHealthcare's administrative charges to Administaff. This reduction equated to an estimated savings of $5 per worksite employee per month beginning in the fourth quarter of 2003.

• **Workers' compensation** – In August, the Company established a new workers' compensation program with members of A++ carrier American International Group, Inc. This customized, loss-sensitive plan included the formation of Administaff Captive Insurance Companies, Ltd., a wholly owned Bermuda-based licensed subsidiary of Administaff. This structure enables us to better manage risk, control costs and maximize the return on the capital invested to collateralize the program.

• **Payroll taxes** – Administaff received its final 2002 and 2003 unemployment tax rates from the Texas Workforce Commission, resulting in a $5.1 million state unemployment tax prepayment balance at year's end. This balance will be used to satisfy future unemployment tax liabilities as incurred.

Progress on legal matters. Administaff received a favorable jury verdict in its case against Aetna Life Insurance Company, its former health insurance carrier for its corporate and worksite employees. In October, the jury found Aetna guilty on several breach-of-contract matters, many of which had been major obstacles in our efforts to match price with cost. The jury awarded Administaff $15.5 million in damages – later reduced to $10.6 million and subject to appeal – and also rejected Aetna's counterclaims. More importantly, the ruling validated Administaff's position in the matter and mitigated a significant distraction for the Company. Following Aetna's appeal of the ruling, we finally settled the matter for $8.25 million, thereby avoiding additional legal expenses and the uncertainty of the appellate process. In the fourth quarter, Administaff collected a $2.0 million reimbursement for defense-related legal fees and costs associated with the Aetna trial from National Union Fire Insurance Company and American International Specialty Lines Insurance Company. In addition, we paid $1.1 million to Texas Property and Casualty Insurance Guaranty Association to settle a $6.8 million dispute that arose from the liquidation of Reliance National Indemnity Co., our former workers' compensation carrier. We expect the settlement to be fully covered by an insurance policy specifically obtained for Reliance-related claims.

Our progress in 2003 was punctuated by a strong fall selling season that marks the start of our renewed sales momentum. Maintaining our year-end sales levels and focusing on client retention will help us to accomplish our goal of re-establishing double-digit unit growth in the fourth quarter. Moreover, we expect to achieve a healthy balance of growth and profitability by continuing to leverage our infrastructure investments and control operating costs.

Like 2003, our goals for this year will only be achieved through the talent and commitment of our corporate employees, along with valuable guidance from our board of directors. Management extends its heartfelt gratitude for the impressive individual and team efforts delivered year after year.

We also express appreciation for our clients who stayed the course while we turned our challenges into opportunities to improve our Company. Entering 2004 with renewed sales momentum, a proven business model and the best offering in the PEO industry, we have never been in a better position to put our premium human resource services into action for the best businesses in America.

Sincerely,
Paul J. Sarvadi
Chairman and Chief Executive Officer
March 22, 2004