

Paylocity Holding Corp  
Form 10-K  
August 10, 2018  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-K

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2018

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 Number 001- 36348

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PAYLOCITY HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware	46-4066644
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification Number)

1400 American Lane

Schaumburg, Illinois 60173

(Address of principal executive offices and zip code)

(847) 463-3200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	The NASDAQ Global Select Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 (§ 232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of December 31, 2017, the last day of registrant's most recently completed second fiscal quarter, was \$1.4 billion (based on the closing price for shares of the registrant's common stock as reported by the NASDAQ Global Select Market for the last business day prior to that date).

As of August 3, 2018, there were 52,767,163 shares of the registrant's common stock issued and outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the Proxy Statement relating to the registrant's 2019 annual meeting of stockholders, which shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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PAYLOCITY HOLDING CORPORATION

Form 10-K

For the Year Ended June 30, 2018

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PART 1

Forward Looking Statements

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-K (as well as documents incorporated herein by reference) may be considered “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, statements regarding our future financial position, business strategy and plans and objectives of management for future operations. When used in this Annual Report, the words “believe,” “may,” “could,” “will,” “estimate,” “continue,” “intend,” “expect,” “anticipate,” “plan,” “project” and similar expressions are intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under Part 1, Item 1A: “Risk Factors” and those discussed in other documents we file with the Securities and Exchange Commission. Except as required by law, we do not intend to update these forward-looking statements publicly or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report and in the documents incorporated in this report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. Accordingly, readers are cautioned not to place undue reliance on such forward-looking statements.

Item 1. Business.

Overview

We are a cloud-based provider of payroll and human capital management, or HCM, software solutions for medium-sized organizations, which we define as those having between 20 and 1,000 employees. Our comprehensive

and easy-to-use solutions enable our clients to manage their workforces more effectively. Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2018, we provided our payroll and HCM software solutions to approximately 16,700 clients across the U.S., which on average had over 100 employees. Our solutions help drive strategic human capital decision-making and improve employee engagement by enhancing the human resource, payroll and finance capabilities of our clients.

Our multi-tenant software platform is highly configurable and includes a unified suite of payroll and HCM applications, such as time and labor tracking, benefits and talent management. Our solutions have been organically developed from our core payroll solution, which we believe is the most critical system of record for medium-sized organizations and an essential gateway to other HCM functionality. Our payroll and HCM applications use a unified database and provide robust on-demand reporting and analytics. Our platform provides intuitive self-service functionality for employees and managers combined with seamless integration across all our solutions. We supplement our comprehensive software platform with an integrated implementation and client service organization, all of which are designed to meet the needs of medium-sized organizations.

Effective management of human capital is a core function in all organizations and requires a significant commitment of resources. Organizations are faced with complex and ever-changing requirements, including diverse federal, state and local regulations across multiple jurisdictions. In addition, the workplace operating environment is rapidly changing as employees increasingly become mobile, work remotely and expect an end user experience similar to



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that of consumer-oriented Internet applications. Medium-sized organizations operating without the infrastructure, expertise or personnel of larger enterprises are uniquely pressured in this complex and dynamic environment. Existing solutions offered by third-party payroll service providers can have limited capabilities and configurability while enterprise-focused software vendors can be expensive and time-consuming to implement and manage. We believe that medium-sized organizations are better served by solutions designed to meet their unique needs.

Our solutions provide the following key benefits to our clients:

- Comprehensive cloud-based platform optimized to meet the payroll and HCM needs of medium-sized organizations;
- Modern, intuitive user experience and self-service capabilities that significantly increase employee engagement;
- Flexible and configurable platform that aligns with business processes and centralizes payroll and HCM data;
- Software as a service, or SaaS, delivery model that reduces total cost of ownership for our clients; and
  - Seamless data integration with our extensive partner ecosystem that saves time and expense and reduces the risk of errors.

We market and sell our products primarily through our direct sales force. We generate sales leads through a variety of focused marketing initiatives and from our extensive referral network of 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants. We derive revenue from a client based on the solutions purchased by the client, the number of client employees and the amount, type and timing of services provided with respect to those client employees. Our annual revenue retention rate was greater than 92% in each of the fiscal years 2016, 2017 and 2018. Our total revenues increased from \$230.7 million in fiscal 2016 to \$300.0 million in fiscal 2017, representing a 30% year-over-year increase and to \$377.5 million in fiscal 2018, representing a 26% year-over-year increase. Our recurring revenues increased from \$220.1 million in fiscal 2016 to \$288.4 million in fiscal 2017, representing a 31% year-over-year increase, and to \$363.5 million in fiscal 2018, representing a 26% year-over-year increase. While the majority of our agreements with clients are generally cancellable on 60 days' or less notice, we have begun entering into term agreements in fiscal 2018, which are generally two years in length. Our recurring revenue model provides significant visibility into our future operating results.

## Industry Background

Effective management of human capital is a core function for all organizations and requires a significant commitment of resources. Identifying, acquiring and retaining talent is a priority at all levels of an organization. In today's increasingly complex business and regulatory environment, organizations are being pressured to manage critical payroll and HCM functions more effectively, automate manual processes and decrease their operating costs.

#### Complex and Dynamic Tax and Regulatory Environment

The tax and regulatory environment in the United States is complex and dynamic. Organizations are subject to a myriad of tax, benefit, workers compensation, healthcare and other rules, regulations and reporting obligations. In addition to U.S. federal taxing and regulatory authorities, there are more than 10,000 state and local tax codes in the United States. Further, federal, state and local government agencies continually enact and amend the rules, regulations and reporting requirements with which organizations must comply.

#### Growing Demand for Mobility and Enhanced User Experience

Connectivity and mobility are enabling employees to spend less time in traditional office environments and more time working remotely. This trend increases the demand for advanced and intuitive solutions that improve

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collaboration and foster employee engagement, such as remote self-service access to payroll and timesheet reporting, HR and benefits portals and other talent management applications. Given the prominence of consumer-oriented Internet applications, employees expect the user experience and accessibility of internal systems to be similar to those of the latest Internet applications, such as LinkedIn, Amazon and Facebook.

### Medium-Sized Organizations Face Unique Challenges

Medium-sized organizations functioning without the infrastructure, expertise or personnel of larger enterprises are uniquely pressured in the current complex and dynamic environment. Employees in these medium-sized organizations often perform multiple job functions, and many medium-sized organizations have limited financial, technical and other resources needed to effectively manage their critical business requirements and to build and maintain the systems required to do so.

### Large Market Opportunity for Payroll and HCM Solutions

The market opportunity in the U.S. for payroll and HCM applications and services is driven by the importance of payroll and HCM solutions to the successful management of organizations. To estimate our addressable market, we focus our analysis on the number of U.S. medium-sized organizations and the number of their employees. According to the U.S. Census Bureau, there were over 625,000 firms with 20 to 999 employees in the U.S. in 2015, employing over 44 million persons. We estimate that if clients were to buy our entire suite of existing solutions at list prices, they would spend approximately \$320 per employee annually. Based on this analysis, we believe our current target addressable market is approximately \$14 billion. Our existing clients do not typically buy our entire suite of solutions, and as we continue to expand our product offerings, we believe that we have an opportunity to increase the amount clients spend on payroll and HCM solutions per employee and to expand our addressable market.

### Organizations Are Increasingly Transitioning to SaaS Solutions

SaaS solutions are easier and more affordable to implement and operate than those offered by traditional software providers. SaaS solutions also enable software updates with greater frequency and without new hardware investments, enabling organizations to better react to changes in their environments. Many organizations are transitioning to SaaS solutions for front-office business applications such as salesforce management. Similarly, we believe organizations are adopting back-office SaaS applications, such as payroll and HCM, with increasing frequency.

### Limitations of Existing Solutions

We believe that existing payroll and HCM solutions have limitations that cause them to underserve the unique needs of medium-sized organizations. Existing payroll and HCM solutions include:

- **Traditional Payroll Service Providers.** Traditional payroll service providers are primarily focused on delivery of a variety of payroll processing services, insurance products and HR business process outsourcing solutions. Many of these solutions offer limited capabilities and integration beyond traditional payroll processing. The lack of a unified and configurable payroll and HCM suite can diminish the effectiveness of a system, detract from user experience and limit integration with other solutions. In addition, we believe that certain traditional payroll service providers often do not provide a high-quality client service experience.
- **Enterprise-Focused Payroll and HCM Software Vendors.** Enterprise-focused software vendors offer solutions and services that are designed for the complex needs and structures of large enterprises. As a result, their solutions can be expensive, complex and time-consuming to implement, operate and maintain.
- **HCM Point Solution Providers.** Many HCM point solutions lack integrated payroll functionality. The implementation and management of multiple point solutions and the reliance on multiple service organizations can be challenging and expensive for medium-sized organizations.

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- Manual Processes for Payroll and HCM Functions. Manual payroll and HCM processes require increased HR, payroll and finance personnel involvement, resulting in higher costs, slower processing and greater risks of data entry errors.

Given the challenges medium-sized organizations face operating in complex and dynamic environments and the limited ability of traditional offerings to address these challenges, we believe there is a significant market opportunity for a comprehensive, unified SaaS solution designed to serve the payroll and HCM needs of medium-sized organizations.

## Segment Information

Our chief operating decision maker reviews our financial results in total when evaluating financial performance and for purposes of allocating resources. We have thus determined that we operate in a single cloud-based software solution reporting segment.

## Our Solution

We are a cloud-based provider of payroll and HCM software solutions for medium-sized organizations. Our solutions enable medium-sized organizations to more efficiently manage payroll and human capital in their complex and dynamic operating environments. Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2018, we provided our payroll and HCM software solutions to approximately 16,700 clients across the U.S., which on average had over 100 employees.

The key benefits of our solution include the following:

- Comprehensive Platform Optimized for Medium-Sized Organizations. Our solutions empower finance and HR professionals in medium-sized organizations to drive strategic human capital decisions by providing enterprise-grade payroll and HCM applications, including robust reporting and analytics. Our unified platform fully automates payroll and HCM processes, enabling our clients to focus on core business activities. Our solutions help our clients attract, retain and manage their employees within a single, comprehensive system.
- Modern, Intuitive User Experience. Our intuitive, easy-to-use interface is based on current technology and automatically adapts to users' devices, including mobile platforms, thereby significantly increasing accessibility of our solutions and decreasing the need for training. Our platform's self-service functionality and performance management applications provide employees with an engaging experience. Our performance management

applications include peer-to-peer employee recognition and social employee profiles that create a reward and recognition environment resulting in greater employee engagement.

- **Flexible and Configurable Platform.** We design our solutions to be flexible and configurable, allowing our clients to match their use of our software with their specific business processes and workflows. Our platform has been organically developed from a common code base, data structure and user interface, providing a consistent user experience with powerful features that are easily adaptable to our clients' needs. Our systems centralize payroll and HCM data, minimizing inconsistent and incomplete information that can be produced when using multiple databases.
- **Highly-Attractive SaaS Solution for Medium-Sized Organizations.** Our solutions are cloud-based and offered on a subscription basis, making them easier and more affordable to implement, operate and update and enabling our clients to focus less on their IT infrastructure and more on their core businesses. Our cloud-based software can be operated by a single administrator without the support of an in-house information technology department. Our multi-tenant and modern architecture allows for frequent software enhancements thereby enabling our clients to react to a rapidly changing and complex operating environment. Our cloud-based platform enables our clients to scale their businesses without having to acquire additional hardware or to resolve the integration challenges that often result from traditional outsourcing solutions.

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- Seamless Integration with Extensive Ecosystem of Partners. Our platform offers our clients automated data integration with over 300 related third-party partner systems, such as 401(k), benefits and insurance provider systems. This integration reduces the complexity and risk of error of manual data transfers and saves time for our clients and their employees. We integrate data with these related systems through a secure connection, which significantly decreases the risk of unauthorized third-party access and other security breaches. Our direct and automated data transmission improves the accuracy of data and facilitates data collection in our partners' systems. We believe having automated data integration with a payroll and HCM provider like us differentiates our partners' product offerings, strengthening their competitive positioning in their own markets.

Our Strategy

We intend to strengthen and extend our position as a provider of cloud-based payroll and HCM software solutions to medium-sized organizations. Key elements of our strategy include:

- Grow Our Client Base. We believe that our current client base represents only a small portion of the medium-sized organizations that could benefit from our solutions. While we provided our payroll and HCM software solutions to approximately 16,700 clients across the U.S. (excluding clients acquired as part of the BeneFLEX acquisition) as of June 30, 2018, there were over 625,000 firms with 20 to 999 employees in the U.S., employing more than 44 million persons, according to the U.S. Census Bureau in 2015. In order to acquire new clients, we plan to continue to grow our sales organization aggressively across all U.S. geographies.
- Expand Our Product Offerings. We believe that our leadership position is in significant part the result of our investment and innovation in our product offerings designed for medium-sized organizations. Therefore, we plan to increase investment in software development to continue to advance our platform and expand our product offerings. For example, in fiscal 2018, we released Compensation Management, which simplifies the employee compensation management process and Surveys, which facilitates the collection of employee feedback.
- Increase Average Revenue Per Client. Our average revenue per client has consistently increased in each of the last three years as we have broadened our product offerings. We plan to further grow average revenue per client by selling a broader selection of products to new and existing clients.
- Extend Technological Leadership. We believe that our organically developed cloud-based multi-tenant software platform, combined with our unified database architecture, enhances the experience and usability of our products, providing what we believe to be a competitive advantage over alternative solutions. Our modern, intuitive user interface utilizes features found on many popular consumer Internet sites, enabling users to use our solutions with limited training. We plan to continue our technology innovation, as we have done with our mobile applications, social features and analytics capabilities.

- Further Develop Our Referral Network. We have developed a strong network of referral participants, such as 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants that recommend our solutions and provide referrals. We believe that our platform's automated data integration with over 300 related third-party partner systems is valuable to our referral participants, as they are able to access payroll and HR data through a single system which decreases complexity and cost and complements their own product offerings. We plan to increase integration with third-party providers and expand our referral network to grow our client base and lower our client acquisition costs.

## Our Products

Our cloud-based platform features a suite of unified payroll and HCM applications. Our solutions are highly configurable and easy to use, implement, update and maintain.

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Payroll (Web Pay)

Paylocity Web Pay is designed to provide enterprise-grade payroll processing and administration from a convenient cloud-based platform. Key features of Web Pay include:

Feature	Functionality
Configurable Templates	<ul style="list-style-type: none"> <li>Combination of standard and modifiable templates powered by highly-flexible drag-and-drop technology</li> <li>Standard templates such as new hire, job change, leave of absence and termination templates</li> <li>Enables users to configure user interface to efficiently align to organizations' business processes</li> <li>Ability to require additional data, add default values and insert new custom fields increases accuracy and consistency of data across the platform</li> </ul>
Custom Checklists	<ul style="list-style-type: none"> <li>Allows users to track critical steps in hiring and other processes</li> <li>Triggers reports and notification emails to track critical steps and informs users when tasks are complete</li> </ul>
Advanced Reporting	<ul style="list-style-type: none"> <li>Easy-to-use, powerful reporting dashboard enables users to design and create ad-hoc reports or rely on over 100 standard reports</li> <li>Ability to generate a variety of pre-process reports via report library and report writer</li> <li>Real-time report generation, including the ability to automatically schedule reports to run on a user-defined frequency</li> <li>Point-in-time reporting, including comparative analysis over multiple periods, allowing users to view data from any time in history</li> </ul>
Data Integration	<ul style="list-style-type: none"> <li>Ability to set up multiple data integrations with a wide array of benefits and retirement plan providers</li> </ul>

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Core HR (Web HR)

Paylocity Web HR provides a set of core HR capabilities designed to improve HR compliance, enhance reporting capabilities and reduce the amount of time necessary to manage employee information. Key features of Web HR include:

Feature	Functionality
Employee Record Management	<ul style="list-style-type: none"> <li>Manage payroll deductions for employee benefit plans such as health and 401(k)</li> <li>Automated employee time-off requests</li> <li>Track employee skills, events, education and prior employment</li> <li>Store employee documentation electronically</li> <li>Record and track company property issued to employees</li> <li>Ability to add custom fields to track additional employee related information</li> </ul>
HR Compliance	<ul style="list-style-type: none"> <li>Automate I-9 work authorization set-up, tracking and monitoring</li> <li>Proactively manage employee policy acknowledgement and signature collection for items such as employee handbooks</li> <li>Assign and track interactive online courses for compliance and other policy needs including sexual harassment training and cybersecurity awareness</li> <li>Manage ACA Compliance activities</li> <li>Facilitate Equal Employment Opportunity (EEO) assessment and filing</li> <li>View relevant industry and regulatory updates with a focus on helping employees understand the potential compliance impact to their business</li> </ul>
HR Reporting	<ul style="list-style-type: none"> <li>Interactive employee organizational chart</li> <li>Family Medical Leave Act (FMLA) tracking</li> <li>EEO reporting</li> <li>Occupational Safety &amp; Health Administration (OSHA) tracking</li> <li>Consolidated Omnibus Budget Reconciliation Act (COBRA) tracking</li> <li>VETS 100/100A reporting</li> <li>Workers' compensation tracking and reporting</li> </ul>
HR Insight and Analytics	<ul style="list-style-type: none"> <li>I-9 verification</li> <li>Provides a year end dashboard to manage IRS deadlines</li> <li>Provides a dashboard view into critical HR metrics such as headcount, employee turnover and potential at-risk employees</li> <li>Users can choose between different types of graphical display or export the information to spreadsheets or other documents</li> <li>Retention dashboard assists employers in identifying and taking action on at-risk employees to improve employee retention</li> <li>Compliance and reporting</li> </ul>
Self-Service Portals	<ul style="list-style-type: none"> <li>Full online and mobile access through virtually any device having Internet access to payroll, HR and benefits information</li> <li>Provides the ability for administrators to communicate company news and policy changes, such as handbook revisions, and to post documents and create custom web pages to</li> </ul>

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communicate with employees

Provides a single view for managers where they can approve employee changes and requests, manage outstanding tasks and easily access employee information

Improves communication among managers and HR and payroll and finance departments

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Talent Management

Paylocity’s Talent suite is designed to bring ease and convenience to the employee performance appraisal process and to give employees the opportunity to participate in their performance review and be more engaged in their professional development. Employee reviews and appraisals throughout the organization are stored and analyzed in a single system. Key features of Talent Management include:

Feature	Functionality
Reviews	<p>Provides the ability for employees and managers to complete online reviews, add comments and sign off on completed reviews</p> <p>Includes automated workflow at each step of the review process with ability for HR administrators to review and provide feedback prior to final approval</p>
360° Feedback	<p>Provides the ability to access feedback from employees across the organization to receive input on employee performance and accomplishments</p> <p>Enables year-round or point-in-time 360° feedback</p>
Goals Management	<p>Manages employee goals and appraisals in a single place to reduce the time required to navigate between screens</p> <p>Allows specific goals to be displayed on the performance review for increased employee focus and development</p> <p>Assigns goals specific to employees based on skill level and other factors</p>
Impressions	<p>Provides employees the ability to recognize each other and provide immediate feedback</p> <p>Impression leaderboard is visible to everyone in the organization providing recognition for top performers</p>
Recruiting	<p>Auto-fills resume information to save time and effort in the candidate’s application process</p> <p>Tracks applicants through the workflow in order to reduce time spent on the recruiting and talent acquisition process and so that users quickly know the status of any prospects at critical stages in the process</p> <p>Serves as a repository of applicant information and feedback for future reference and sourcing</p>
Onboarding	<p>Features a mobile-responsive design and attractive, intuitive interface, engaging new hires in the process</p> <p>Provides robust events management capabilities, empowering administrators to proactively manage the onboarding process</p> <p>Highly configurable, allowing administrators to tailor tasks and overall experience for new hires</p> <p>Includes a withholding forms wizard, simplifying the process of completing important tax-related paperwork</p>

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Journals	Permits the ability to add customized content including welcome message, documents, videos and other company specific information
Compensation Management	Captures and tracks ongoing discussions with employees to support performance appraisals Enables compensation professionals to configure tailored compensation plans and create automated approval workflows based on organizational pay cycles
	Creates visibility to an executive-level view of organizational and team budgets and payment allocations
Surveys	Offers managers the ability to manage their budgets and distribute compensation increases by drilling down into employee performance, pay history and more Facilitates the collection and summarization of employee feedback

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Time & Labor (Web Time and Web Expense)

Paylocity Web Time is a time and attendance solution designed to automate manual processes, improve productivity and help organizations control labor costs. Key features of Web Time include:

Feature	Functionality
Task Management	<ul style="list-style-type: none"> <li>Scheduling management</li> <li>Time and attendance tracking, including overtime, rounding rules, payroll policies, labor allocation and time-off accruals</li> <li>Tracks tardiness, absenteeism, and misuse of break or meal periods</li> </ul>
Multiple Hardware Options	<ul style="list-style-type: none"> <li>Functions with a wide variety of biometric and bar code hardware options to track employees' time</li> </ul>
Mobile Functionality	<ul style="list-style-type: none"> <li>Ability for employees to punch in and out from their mobile devices</li> <li>Enables employees to view upcoming work schedules or request time-off from anywhere</li> <li>Geo-fencing capabilities that allow managers to set parameters for where punches may occur</li> </ul>

Paylocity Web Expense is an expense management tool designed to streamline and automate the expense management process by eliminating manual steps involved in filing, approving, and reimbursing expenses. Key features of Web Expense include:

Feature	Functionality
	<ul style="list-style-type: none"> <li>File and submit expenses in an intuitive and unified module</li> </ul>
Simplified Workflow	<ul style="list-style-type: none"> <li>Capture and submit receipts from a mobile device</li> <li>Approve expense reports quickly and easily</li> </ul>
Monitoring	<ul style="list-style-type: none"> <li>Receive notifications throughout the entire reimbursement process</li> <li>Access expense history</li> </ul>
Automated Reporting	<ul style="list-style-type: none"> <li>Generate and analyze spend reports</li> <li>Automatically create general ledger entries</li> </ul>

Benefits (Web Benefits)

Paylocity Web Benefits and Paylocity Enterprise Benefits, Powered by bswift are benefit management solutions that integrate with insurance carrier systems to provide automated administrative processes and allow users to choose benefit elections and make life event changes online, summarize benefit elections and perform other similar benefit-related tasks. These solutions also enable premium reconciliation, management of voluntary benefits and advanced reporting. Both Web Benefits and Paylocity Enterprise Benefits integrate seamlessly with Paylocity's Web

Pay. Key features of Web Benefits include:

Feature	Functionality
Annual Enrollment	Easy to follow and customizable enrollment process for employees
	Allows modeling of payroll deductions and changes for life events
	Customizable enrollment portal content (text, links, documents, logos)
Administrative Efficiency	Can develop enrollment reminders through announcements, enrollment rules, and eligibility groups
	Reporting on employee enrollment status and enrollment summary
	Electronic Data Interchange (EDI) support for insurance carriers

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### Third-Party Administrative (TPA) Services

Paylocity's TPA services provide solutions for clients designed to modernize the administration of Flexible Spending Account (FSA), Health Savings Account (HSA), Transportation Management Account (TMA), Premium Only Plan (POP) and Health Reimbursement Arrangement (HRA) for their employees.

### Implementation and Client Services

Delivering our clients a positive experience is an essential element of our ability to sell our solutions and retain our clients. We provide our clients with a single point of contact supplemented by teams with deep technical and subject matter expertise. The single point of contact allows our account managers to better understand our clients' needs, which we believe strengthens our client relationships.

### Implementation and Training Services

Our clients are medium-sized organizations that are typically migrating to our platform from a competitive solution or are adopting an online payroll and HCM solution for the first time. These organizations often have limited internal resources and rely on us to implement our solutions.

We typically implement our Paylocity Web Pay product within only three to four weeks and any additional products thereafter, as requested by the client. Each client is guided through the implementation process by knowledgeable consultants for all implementation matters. We believe our ability to rapidly implement our solutions is principally due to the combination of our emphasis on engagement with the client, our standardized methodology, our cloud-based architecture and our highly-configurable, easy-to-use products.

We offer our clients the opportunity to utilize on demand or in class training. Our training courses are designed to enable selected employees of our clients to develop general knowledge in our solutions and act as a first-level support resource for their colleagues. We also host an annual client conference for our clients to disseminate new products and features and to allow clients to provide feedback and learn best practices.

In order to ensure client satisfaction, a team of client service representatives conducts a comprehensive audit of a client's account after the client has completed the implementation process. Thereafter, the client is transitioned to our client service team.



## Client Service

Our client service model is designed to serve the needs of medium-sized organizations and to build loyalty by developing strong relationships with our clients. We strive to achieve high revenue retention, in part, by delivering high-quality service. Our revenue retention was greater than 92% in each of fiscal 2016, 2017 and 2018.

Each client is assigned an account management team that serves as the central point of contact for any questions or support needs. We believe this approach enhances our client service by providing each client with a single person who understands the client's business, responds quickly and is accountable for the client experience. Our account managers are supplemented by teams with deep technical and subject matter expertise who help to expediently and effectively address client needs. We also proactively solicit client feedback through ongoing surveys from which we receive actionable feedback that we use to enhance our client service processes.

## Tax and Regulatory Services

Our software contains a rules engine designed to make accurate tax calculations that is continually updated to support all pertinent legislative changes across all U.S. jurisdictions. Our tax filing service provides a variety of solutions to our clients including processing payroll tax deposits, preparing and filing quarterly and annual tax returns and amendments and resolving client tax notices.

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### Clients

Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2018, we provided our payroll and HCM software solutions to approximately 16,700 clients in all U.S states. The rate at which we add clients is highly variable period-to-period and highly seasonal as many clients switch solutions during the first calendar quarter of each year. Although many clients have multiple divisions, segments or locations, we only count such clients once for these purposes.

Our clients include for-profit and non-profit organizations across industries including business services, financial services, healthcare, manufacturing, restaurants, retail, technology and others. For each of the three years ended June 30, 2016, 2017 and 2018, no client accounted for more than 1% of our revenues.

### Sales and Marketing

We market and sell our products and services primarily through our direct sales force. Our direct sales force includes sales representatives who have defined geographic territories throughout the U.S. We seek to hire experienced sales representatives wherever they are located, and believe we have room to grow the number of sales representatives in each of our territories.

The sales cycle begins with a sales lead generated by the sales representative through our third-party referral network, a client referral, our telemarketing team, our external website, e-mail marketing or territory- based activities. Through one or more on-site visits, phone-based sales calls, or web demonstrations, sales representatives perform in-depth analysis of prospective clients' needs and demonstrate our solutions. We employ sophisticated software to track, classify and manage our sales representatives' pipeline of potential clients. We support our sales force with a marketing program that includes seminars and webinars, email marketing, social media marketing, broker events and web marketing.

### Referral Network

As a core element of our business strategy, we have developed a referral network of third-party service providers, including 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants, that recommend our solutions and provide referrals. Our referral network has become an increasingly important component of our sales process, and in fiscal 2018, more than 25% of our new client revenue originated by referrals from participants in our referral network.

We believe participants in our referral network refer potential clients to us because we do not provide services that compete with their own and because we offer third parties the ability to integrate their systems with our platform. Unlike other payroll and HCM solution providers who also provide retirement plans, health insurance and other products and services competitive with the offerings of the participants in our referral network, we focus only on our core business of providing cloud-based payroll and HCM solutions. In some cases, we have formalized relationships in which we are a recommended vendor of these participants. In other cases, our relationships are informal. We typically do not compensate these participants for referrals.

#### Partner Ecosystem

We have developed a partner ecosystem of third-party systems, such as 401(k), benefits and insurance provider systems, with whom we provide automated data integration for our clients. These third-party providers require certain financial information from their clients in order to efficiently provide their respective services. After securing authorization from the client, we exchange payroll data with these providers. In turn, these third-party providers supply data to us, which allows us to deliver comprehensive benefit management services to our clients. We believe our partnerships with these third parties are an important part of our service offerings.

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We have also developed our solutions to integrate with a variety of other systems used by our clients, such as accounting, point of sale, banking, expense management, recruiting, background screening and skills assessment solutions. We believe our clients benefit from an integrated and seamless solution.

## Technology

We offer our solutions on a cloud-based platform that leverages a unified database architecture and a common code base that we organically developed. Clients do not need to install our software in their data centers and can access our solutions through any mobile device or web browser with Internet access.

- **Multi-Tenant Architecture.** Our software solutions were designed with a multi-tenant architecture. This architecture gives us an advantage over many disparate traditional systems, which are less flexible and require longer and more costly development and upgrade cycles.
- **Mobile Focused.** We employ mobile-centric principles in our solution design and development. We believe that the increasing mobility of employees heightens the importance of access to our solutions through mobile devices, including smart phones and tablets. Our mobile experience provides our clients and their employees with access to our solutions through virtually any device having Internet access. We bring the flexibility of a secure, cloud-based solution to users without the need to access a traditional desktop or laptop computer.
- **Security.** We maintain comprehensive security programs designed to ensure the security and integrity of client and employee data, protect against security threats or data breaches and prevent unauthorized access. We regulate and limit all access to servers and networks at our data centers. Our systems are monitored for irregular or suspicious activity, and we have dedicated internal staff perform security assessments for each release. Our systems undergo regular penetration testing and source code reviews by an independent third-party security firm.

We host our solutions at a third-party facility in Franklin Park, Illinois and utilize another third-party facility in Kenosha, Wisconsin for backup and disaster recovery. We supply the hardware infrastructure and are responsible for the ongoing maintenance of our equipment at all data center locations.

## Competition

The market for payroll and HCM solutions is fragmented, highly competitive and rapidly changing. Our competitors vary for each of our solutions and include enterprise-focused software providers, such as Ultimate Software Group, Inc., Workday, Inc., SAP AG, Oracle Corporation and Ceridian Corporation; payroll service providers, such as Automatic Data Processing, Inc., Paychex, Inc., Paycom Software, Inc., Paycor, Inc. and other regional providers; and

HCM point solutions providers, such as Cornerstone OnDemand, Inc.

We believe the principal competitive factors on which we compete in our market include the following:

- Focus on medium-sized organizations;
- Breadth and depth of product functionality;
- Configurability and ease of use of our solutions;
- Modern, intuitive user experience;
- Benefits of a cloud-based technology platform;
- Ability to innovate and respond to client needs rapidly;

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- Domain expertise in payroll and HCM;
- Quality of implementation and client service;
- Ease of implementation;
- Real-time web-based payroll processing; and
- Access to a wide variety of complementary third-party service providers.

We believe that we compete favorably on these factors within the medium-sized organization market. We believe our ability to remain competitive will largely depend on the success of our continued investment in sales and marketing, research and development and implementation and client services.

## Research and Development

We invest heavily in research and development to continuously introduce new applications, technologies, features and functionality. We are organized in small product-centric teams that utilize an agile development methodology. We focus our efforts on developing new applications and core technologies and on further enhancing the usability, functionality, reliability, performance and flexibility of existing applications.

Research and development costs, including research and development costs that were capitalized, were \$36.3 million, \$44.5 million and \$55.7 million for the years ended June 30, 2016, 2017 and 2018, respectively. Our research and development personnel are principally located at our headquarters, although we seek to hire highly experienced personnel wherever they are located.

## Intellectual Property

Our success is dependent, in part, on our ability to protect our proprietary technology and other intellectual property rights. We rely on a combination of trade secrets, copyrights and trademarks, as well as contractual protections to establish and protect our intellectual property rights. We require our employees, consultants and other third parties to enter into confidentiality and proprietary rights agreements and control access to software, documentation and other proprietary information. Although we rely on laws respecting intellectual property rights, including trade secret, copyright and trademark laws, as well as contractual protections to establish and protect our intellectual property

rights, we believe that factors such as the technological and creative skills of our personnel, creation of new modules, features and functionality and frequent enhancements to our applications are more essential to establishing and maintaining our technology leadership position.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to misappropriate our rights or to copy or obtain and use our proprietary technology to develop applications with the same functionality as our applications. Policing unauthorized use of our technology and intellectual property rights is very difficult.

We expect that providers of payroll and HCM solutions such as ours may be subject to third-party infringement claims as the market and the number of competitors grows, and the functionality of applications in different industry segments overlaps. Any of these or other third parties might make a claim of infringement against us at any time.

## Employees

As of June 30, 2018, we had approximately 2,600 full-time employees. None of our employees is represented by a union or is party to a collective bargaining agreement, and we have not experienced any work stoppages. We believe we have good relations with our employees and that our employee-focused culture benefits our clients and supports our growth. Our management team is committed to maintaining and improving our culture even as we grow rapidly.

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Available Information

Our Internet address is [www.paylocity.com](http://www.paylocity.com) and our investor relations website is located at <http://investors.paylocity.com>. We make available free of charge on our investor relations website under the heading “Financials” our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with (or furnished to) the SEC. Information contained on our websites is not incorporated by reference into this Annual Report on Form 10-K. In addition, the public may read and copy materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site, [www.sec.gov](http://www.sec.gov), that includes filings of and information about issuers that file electronically with the SEC.

Item 1A. Risk Factors.

Our business, prospects, financial condition or operating results could be materially adversely affected by any of these risks, as well as other risks not currently known to us or that are currently considered immaterial. The trading price of our common stock could decline due to any of the risks and uncertainties described below, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this Annual Report on Form 10-K, including our consolidated financial statements and related notes.

Our quarterly operating results have fluctuated in the past and may continue to fluctuate, which may cause the value of our common stock to decline substantially.

Our quarterly operating results may fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. Moreover, our stock price might be based on expectations of future performance that are unrealistic or that we might not meet and, if our revenue or operating results fall below such expectations, the price of our common stock could decline substantially.

Our number of new clients typically increases more during our third fiscal quarter ending March 31 than during the rest of our fiscal year, primarily because many new clients prefer to start using our payroll and human capital management, or HCM, solutions at the beginning of a calendar year. In addition, client funds and year-end activities are traditionally higher during our third fiscal quarter. As a result of these factors, our total revenue and expenses have historically grown disproportionately during our third fiscal quarter as compared to other quarters.



In addition to other risk factors listed in this section, some of the important factors that may cause fluctuations in our quarterly operating results include:

- The extent to which our products achieve or maintain market acceptance;
- Our ability to introduce new products and enhancements and updates to our existing products on a timely basis;
- Competitive pressures and the introduction of enhanced products and services from competitors;
- Changes in client budgets and procurement policies;
- The amount and timing of our investment in research and development activities and whether such investments are capitalized or expensed as incurred;
- The number of our clients' employees;
- Timing of recognition of revenues and expenses;
- Client renewal rates;

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- Seasonality in our business;
- Technical difficulties with our products or interruptions in our services;
- Our ability to hire and retain qualified personnel;
- A repeal of or changes to the laws and regulations related to the products and services which we offer;
- Changes in accounting principles; and
- Unforeseen legal expenses, including litigation and settlement costs.

The majority of our agreements with clients do not have a specified term and are generally cancellable by our clients upon 60 days' or less notice; however, in fiscal 2018, the Company also began entering into term agreements, which are generally two years long. If a significant number of clients elected to terminate their agreements with us, our operating results and our business would be adversely affected.

In addition, a significant portion of our operating expenses are related to compensation and other items which are relatively fixed in the short-term, and we plan expenditures based in part on our expectations regarding future needs and opportunities. Accordingly, changes in our business or revenue shortfalls could decrease our gross and operating margins and could cause significant changes in our operating results from period to period. If this occurs, the trading price of our common stock could fall substantially, either suddenly or over time.

Our operating results for previous fiscal quarters are not necessarily indicative of our operating results for the full fiscal years or for any future periods. We believe that, due to the underlying factors for quarterly fluctuations, quarter-to-quarter comparisons of our operations are not necessarily meaningful and that such comparisons should not be relied upon as indications of future performance.

Failure to manage our growth effectively could increase our expenses, decrease our revenue, and prevent us from implementing our business strategy.

We have been rapidly growing our revenue and number of clients, and we will seek to do the same for the foreseeable future. However, the growth in our number of clients puts significant strain on our business, requires significant

capital expenditures and increases our operating expenses. To manage this growth effectively, we must attract, train, and retain a significant number of qualified sales, implementation, client service, software development, information technology and management personnel. We also must maintain and enhance our technology infrastructure and our financial and accounting systems and controls. If we fail to effectively manage our growth or we over-invest or under-invest in our business, our business and results of operations could suffer from the resultant weaknesses in our infrastructure, systems or controls. We could also suffer operational mistakes, a loss of business opportunities and employee losses. If our management is unable to effectively manage our growth, our expenses might increase more than expected, our revenue could decline or might grow more slowly than expected, and we might be unable to implement our business strategy.

The markets in which we participate are highly competitive, and if we do not compete effectively, our operating results could be adversely affected.

The market for payroll and HCM solutions is fragmented, highly competitive and rapidly changing. Our competitors vary for each of our solutions, and include enterprise-focused software providers, such as Ultimate Software Group, Inc., Workday, Inc., SAP AG, Oracle Corporation and Ceridian Corporation, payroll service providers, such as Automatic Data Processing, Inc., Paychex, Inc., Paycom Software, Inc., Paycor, Inc. and other regional providers, and HCM point solutions, such as Cornerstone OnDemand, Inc.

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Several of our competitors are larger, have greater name recognition, longer operating histories and significantly greater resources than we do. Many of these competitors are able to devote greater resources to the development, promotion and sale of their products and services. Furthermore, our current or potential competitors may be acquired by third parties with greater available resources and the ability to initiate or withstand substantial price competition. As a result, our competitors may be able to develop products and services better received by our markets or may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, regulations or client requirements.

In addition, current and potential competitors have established, and might in the future establish, partner or form other cooperative relationships with vendors of complementary products, technologies or services to enable them to offer new products and services, to compete more effectively or to increase the availability of their products in the marketplace. New competitors or relationships might emerge that have greater market share, a larger client base, more widely adopted proprietary technologies, greater marketing expertise, greater financial resources, and larger sales forces than we have, which could put us at a competitive disadvantage. In light of these advantages, current or potential clients might accept competitive offerings in lieu of purchasing our offerings. We expect intense competition to continue for these reasons, and such competition could negatively impact our sales, profitability or market share.

If we do not continue to innovate and deliver high-quality, technologically advanced products and services, we will not remain competitive and our revenue and operating results could suffer.

The market for our solutions is characterized by rapid technological advancements, changes in client requirements, frequent new product introductions and enhancements and changing industry standards. The life cycles of our products are difficult to estimate. Rapid technological changes and the introduction of new products and enhancements by new or existing competitors could undermine our current market position.

Our success depends in substantial part on our continuing ability to provide products and services that medium-sized organizations will find superior to our competitors' offerings and will continue to use. We intend to continue to invest significant resources in research and development in order to enhance our existing products and services and introduce new high-quality products that clients will want. If we are unable to predict user preferences or industry changes, or if we are unable to modify our products and services on a timely basis or to effectively bring new products to market, our sales may suffer.

In addition, we may experience difficulties with software development, industry standards, design, or marketing that could delay or prevent our development, introduction or implementation of new solutions and enhancements. The introduction of new solutions by competitors, the emergence of new industry standards or the development of entirely new technologies to replace existing offerings could render our existing or future solutions obsolete.

We may not have sufficient resources to make the necessary investments in software development and we may experience difficulties that could delay or prevent the successful development, introduction or marketing of new products or enhancements. In addition, our products or enhancements may not meet the increasingly complex client requirements of the marketplace or achieve market acceptance at the rate we expect, or at all. Any failure by us to anticipate or respond adequately to technological advancements, client requirements and changing industry standards, or any significant delays in the development, introduction or availability of new products or enhancements, could undermine our current market position.

If we are unable to release periodic updates on a timely basis to reflect changes in tax, benefit and other laws and regulations that our products help our clients address, the market acceptance of our products may be adversely affected and our revenues could decline.

Our solutions are affected by changes in tax, benefit and other laws and regulations and generally must be updated regularly to maintain their accuracy and competitiveness. Although we believe our SaaS platform provides us with flexibility to release updates in response to these changes, we cannot be certain that we will be able to make the necessary changes to our solutions and release updates on a timely basis, or at all. Failure to do so could have an adverse effect on the functionality and market acceptance of our solutions. Changes in tax, benefit and other laws and regulations

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could require us to make significant modifications to our products or delay or cease sales of certain products, which could result in reduced revenues or revenue growth and our incurring substantial expenses and write-offs.

If we fail to manage our technical operations infrastructure, including operation of our data centers, our existing clients may experience service outages and our new clients may experience delays in the deployment of our applications.

We have experienced significant growth in the number of users, transactions and data that our operations infrastructure supports. We seek to maintain sufficient excess capacity in our data center and other operations infrastructure to meet the needs of all of our clients. We also seek to maintain excess capacity to facilitate the rapid provision of new client deployments and the expansion of existing client deployments. In addition, we need to properly manage our technological operations infrastructure in order to support version control, changes in hardware and software parameters and the evolution of our applications. However, the provision of new hosting infrastructure requires significant lead time. We have experienced, and may in the future experience, website disruptions, outages and other performance problems. These problems may be caused by a variety of factors, including infrastructure changes, human or software errors, viruses, security attacks, fraud, spikes in client usage and denial of service issues. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. If we do not accurately predict our infrastructure requirements, our existing clients may experience service outages that may subject us to financial penalties, financial liabilities and client losses. If our operations infrastructure fails to keep pace with increased sales, clients may experience delays as we seek to obtain additional capacity, which could adversely affect our reputation and our revenues.

In addition, our ability to deliver our cloud-based applications depends on the development and maintenance of Internet infrastructure by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity, bandwidth capacity, and security. Our services are designed to operate without interruption. However, we have experienced and expect that we will experience future interruptions and delays in services and availability from time to time. In the event of a catastrophic event with respect to one or more of our systems, we may experience an extended period of system unavailability, which could negatively impact our relationship with clients. To operate without interruption, both we and our clients must guard against:

- Damage from fire, power loss, natural disasters and other force majeure events outside our control;
- Communications failures;
- Software and hardware errors, failures and crashes;
- Security breaches, computer viruses, hacking, denial-of-service attacks and similar disruptive problems; and

- Other potential interruptions.

We also rely on computer hardware purchased or leased and software licensed from third parties in order to offer our services. These licenses and hardware are generally commercially available on varying terms. However, it is possible that this hardware and software might not continue to be available on commercially reasonable terms, or at all. Any loss of the right to use any of this hardware or software could result in delays in the provisioning of our services until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated.

Furthermore, our payroll application is essential to our clients' timely payment of wages to their employees. Any interruption in our service may affect the availability, accuracy or timeliness of these programs and could damage our reputation, cause our clients to terminate their use of our application, require us to indemnify our clients against certain losses due to our own errors and prevent us from gaining additional business from current or future clients.

We host our solutions at a third-party facility in Franklin Park, Illinois and utilize another third-party facility in Kenosha, Wisconsin for backup and disaster recovery. We also may decide to employ additional offsite data centers in

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the future to accommodate growth. Problems faced by our data center locations, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their clients, including us, could adversely affect the availability and processing of our solutions and related services and the experience of our clients. If our data centers are unable to keep up with our growing needs for capacity, this could have an adverse effect on our business and cause us to incur additional expense. In addition, any financial difficulties faced by our third-party data center's operator or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Any changes in service levels at our third-party data center or any errors, defects, disruptions or other performance problems with our applications could adversely affect our reputation and may damage our clients' stored files or result in lengthy interruptions in our services. Interruptions in our services might reduce our revenues, subject us to potential liability or other expenses or adversely affect our renewal rates.

In addition, while we own, control and have access to our servers and all of the components of our network that are located in our backup data centers, we do not control the operation of these facilities. The operators of our third party data center facilities have no obligations to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, or if the data center operators are acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur costs and experience service interruption in doing so.

If our security measures are breached or unauthorized access to client data or funds is otherwise obtained, our solutions may be perceived as not being secure, clients may reduce the use of or stop using our solutions and we may incur significant liabilities.

Our solutions involve the storage and transmission of our clients' and their employees' proprietary and confidential information. This information includes bank account numbers, tax return information, social security numbers, benefit information, retirement account information, payroll information, system passwords, and in the case of our benefit administration solution, BeneFLEX, health information protected by the Health Insurance Portability and Accountability Act of 1996, as amended, or HIPAA. In addition, we collect and maintain personal information on our own employees in the ordinary course of our business. Finally, our business involves the storage and transmission of funds from the accounts of our clients to their employees, taxing and regulatory authorities and others. As a result, unauthorized access or security breaches of our systems or the systems of our clients could result in the unauthorized disclosure of confidential information, theft, litigation, indemnity obligations and other significant liabilities. Because the techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are employed, we may be unable to anticipate these techniques or to implement adequate preventative measures in advance. While we have security measures and controls in place to protect confidential information, prevent data loss, theft and other security breaches, including penetration tests of our systems by independent third parties, if our security measures are breached, our business could be substantially harmed and we could incur significant liabilities. The costs of investigating, mitigating, and reporting such a breach to affected individuals (if required) can be substantial. In addition, if a high-profile security breach occurs with respect to an industry peer, our clients and potential clients may generally lose trust in the security of payroll and HCM applications. Any such breach or unauthorized access could negatively affect our ability to attract new clients, cause existing clients to terminate their agreements with us, result in reputational damage and subject us to lawsuits, regulatory fines (including, in the case of our benefit administration solution, BeneFLEX, penalties for failure to



comply with HIPAA) or other actions or liabilities which could materially and adversely affect our business and operating results.

There can be no assurance that the limitations of liability in our contracts would be enforceable or adequate or would otherwise protect us from any such liabilities or damages with respect to any particular claim related to a breach or unauthorized access. We also cannot be sure that our existing general liability insurance coverage and coverage for errors or omissions will continue to be available on acceptable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, financial condition and results of operations.

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Because of the way we recognize our revenue and our expenses over varying periods, changes in our business may not be immediately reflected in our financial statements.

We recognize our revenue as services are performed. The amount of revenue we recognize in any particular period is derived in significant part based on the number of employees of our clients served by our solutions. As a result, our revenue is dependent in part on the success of our clients. The effect on our revenue of significant changes in sales of our solutions or in our clients' businesses may not be fully reflected in our results of operations until future periods.

We recognize our expenses over varying periods based on the nature of the expense. In particular, we recognize certain costs as they are incurred even though we recognize revenue as we perform services over extended periods. When a client terminates its relationship with us, we may not have derived enough revenue from that client to cover associated implementation costs. As a result, we may report poor operating results due to higher costs in a period in which we experience strong sales of our solutions. Alternatively, we may report better operating results due to lower costs in a period in which we experience a slowdown in sales. As a result, our expenses fluctuate as a percentage of revenue, and changes in our business generally may not be immediately reflected in our results of operations.

If we fail to adequately expand our direct sales force with qualified and productive persons, we may not be able to grow our business effectively.

We primarily sell our products and implementation services through our direct sales force. To grow our business, we intend to focus on growing our client base for the foreseeable future. Our ability to add clients and to achieve revenue growth in the future will depend upon our ability to grow and develop our direct sales force and on their ability to productively sell our solutions. Identifying and recruiting qualified personnel and training them in the use of our software require significant time, expense and attention. The amount of time it takes for our sales representatives to be fully-trained and to become productive varies widely. In addition, if we hire sales representatives from competitors or other companies, their former employers may attempt to assert that these employees have breached their legal obligations, resulting in a diversion of our time and resources.

If our sales organization does not perform as expected, our revenues and revenue growth could suffer. In addition, if we are unable to hire, develop and retain talented sales personnel, if our sales force becomes less efficient as it grows or if new sales representatives are unable to achieve desired productivity levels in a reasonable period of time, we may not be able to grow our client base and revenues and our sales and marketing expenses may increase.

If our referral network participants reduce their referrals to us, we may not be able to grow our client base or revenues in the future.

Referrals from third-party service providers, including 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants, represent a significant source of potential clients for our products and implementation services. For example, we estimate that more than 25% of our new sales in fiscal 2018 were referred to us from our referral network participants. In most cases, our relationships with referral network participants are informal, although in some cases, we have formalized relationships where we are a recommended vendor for their client.

Participants in our referral network are generally under no contractual obligation to continue to refer business to us, and we do not intend to seek contractual relationships with these participants. In addition, these participants are generally not compensated for referring potential clients to us, and may choose to instead refer potential clients to our competitors. Our ability to achieve revenue growth in the future will depend, in part, upon continued referrals from our network.

There can be no assurance that we will be successful in maintaining, expanding or developing our referral network. If our relationships with participants in our referral network were to deteriorate or if any of our competitors enter into strategic relationships with our referral network participants, sales leads from these participants could be reduced or cease entirely. If we are not successful, we may lose sales opportunities and our revenues and profitability could suffer.

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If the market for cloud-based payroll and HCM solutions among medium-sized organizations develops more slowly than we expect or declines, our business could be adversely affected.

We believe that the market for cloud-based payroll and HCM solutions is not as mature among medium-sized organizations as the market for outsourced services or on-premise software and services. It is not certain that cloud-based solutions will achieve and sustain high levels of client demand and market acceptance. Our success will depend to a substantial extent on the widespread adoption by medium-sized organizations of cloud-based computing in general, and of payroll and other HCM applications in particular. It is difficult to predict client adoption rates and demand for our solutions, the future growth rate and size of the cloud-based market or the entry of competitive solutions. The expansion of the cloud-based market depends on a number of factors, including the cost, performance, and perceived value associated with cloud-based computing, as well as the ability of cloud-based solutions to address security and privacy concerns. If other cloud-based providers experience security incidents, loss of client data, disruptions in delivery or other problems, the market for cloud-based applications as a whole, including our solutions, may be negatively affected. If cloud-based payroll and HCM solutions do not achieve widespread adoption among medium-sized organizations, or there is a reduction in demand for cloud-based computing caused by a lack of client acceptance, technological challenges, weakening economic conditions, security or privacy concerns, competing technologies and products, decreases in corporate spending or otherwise, it could result in a loss of clients, decreased revenues and an adverse impact on our business.

We may not be able to sustain or increase profitability in the future.

We generated net income in fiscal 2017 and fiscal 2018; however, we may not be able to sustain or increase profitability in future periods. We have been growing our number of clients rapidly, and as we do so, we incur significant sales and marketing, services and other related expenses. Our profitability will be significantly influenced by our ability to attain sufficient scale and productivity to achieve recurring revenues that are sufficient to support the incremental costs to obtain and support new clients. We intend for the foreseeable future to continue to focus predominately on adding new clients, and we also expect to make other significant expenditures and investments in research and development to expand and improve our product offerings and technical infrastructure. We also may not be able to sustain or increase profitability in the future for a number of other unforeseen reasons. Therefore, our profitability may decrease, we may cease to be profitable, or we may incur operating losses in the future.

We typically pay employees and may pay taxing authorities amounts due for a payroll period before a client's electronic funds transfers are finally settled to our account. If client payments are rejected by banking institutions or otherwise fail to clear into our accounts, we may require additional sources of short-term liquidity and our operating results could be adversely affected.

Our payroll processing business involves the movement of significant funds from the account of a client to employees and relevant taxing authorities. For example, in fiscal 2018 we processed over \$110 billion in payroll transactions. Though we debit a client's account prior to any disbursement on its behalf, due to Automated Clearing House, or ACH,

banking regulations, funds previously credited could be reversed under certain circumstances and timeframes after our payment of amounts due to employees and taxing and other regulatory authorities. There is therefore a risk that the employer's funds will be insufficient to cover the amounts we have already paid on its behalf. While such shortage and accompanying financial exposure has only occurred in very limited instances in the past, should clients default on their payment obligations in the future, we might be required to advance substantial amounts of funds to cover such obligations. In such an event, we may be required to seek additional sources of short-term liquidity, which may not be available on reasonable terms, if at all, and our operating results and our liquidity could be adversely affected and our banking relationships could be harmed.

Adverse changes in economic or political conditions could adversely affect our operating results and our business.

Our recurring revenues are based in part on the number of our clients' employees. As a result, we are subject to risks arising from adverse changes in economic and political conditions. The state of the economy and the rate of employment, which deteriorated in the recent broad recession, may deteriorate again in the future. If the current economic climate begins to decline, many clients may reduce their number of employees and delay or reduce technology

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purchases. This could also result in reductions in our revenues and sales of our products, longer sales cycles, increased price competition and clients' purchasing fewer solutions than they have in the past. Any of these events would likely harm our business, results of operations, financial condition and cash flows from operations.

Trade, monetary and fiscal policies, and political and economic conditions may substantially change, and credit markets may experience periods of constriction and volatility. When there is a slowdown in the economy, employment levels and interest rates may decrease with a corresponding impact on our businesses. Clients may react to worsening conditions by reducing their spending on payroll and other HCM solutions or renegotiating their contracts with us. We have agreements with various large banks to execute ACH and wire transfers as part of our client payroll and tax services. While we have contingency plans in place for bank failures, a failure of one of our banking partners or a systemic shutdown of the banking industry could result in the loss of client funds or impede us from accessing and processing funds on our clients' behalf, and could have an adverse impact on our business and liquidity.

If the banks that currently provide ACH and wire transfers fail to properly transmit ACH or terminate their relationship with us or limit our ability to process funds or we are not able to increase our ACH capacity with our existing and new banks, our ability to process funds on behalf of our clients and our financial results and liquidity could be adversely affected.

We currently have agreements with eleven banks to execute ACH and wire transfers to support our client payroll, benefit and tax services. If one or more of the banks fails to process ACH transfers on a timely basis, or at all, then our relationship with our clients could be harmed and we could be subject to claims by a client with respect to the failed transfers. In addition, these banks have no obligation to renew their agreements with us on commercially reasonable terms, if at all. If these banks terminate their relationships with us or restrict the dollar amounts of funds that they will process on behalf of our clients, their doing so may impede our ability to process funds and could have an adverse impact on our financial results and liquidity.

We depend on our senior management team and other key employees, and the loss of these persons or an inability to attract and retain highly skilled employees, including product development and other technical persons, could adversely affect our business.

Our success depends largely upon the continued services of our key executive officers, including Steven R. Beauchamp, our Chief Executive Officer. We also rely on our leadership team in the areas of research and development, sales, services and general and administrative functions. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. While we have employment agreements with our executive officers, including Mr. Beauchamp, these employment agreements do not require them to continue to work for us for any specified period and, therefore, they could terminate their employment with us at any time. The loss of one or more of our executive officers or key employees could have an adverse effect on our business.

We believe that to grow our business and be successful, we must continue to develop products that are technologically-advanced, are highly integrable with third-party services, provide significant mobility capabilities and have pleasing and intuitive user experiences. To do so, we must attract and retain highly qualified personnel, particularly employees with high levels of experience in designing and developing software and Internet-related products and services. Competition for these personnel in the greater Chicago area and elsewhere is intense. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed. We follow a practice of hiring the best available candidates wherever located, but as we grow our business, the productivity of our product development and other research and development may be adversely affected. In addition, if we hire employees from competitors or other companies, their former employers may attempt to assert that these employees have breached their legal obligations, resulting in a diversion of our time and resources.

Our business may be adversely impacted if the Patient Protection and Affordable Care Act, or the ACA, is repealed in its entirety or certain aspects of the ACA are repealed or changed.

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The ACA remains subject to legislative efforts to repeal, modify or delay the implementation of all or certain aspects of the law. Generally, if the ACA is repealed or modified in whole or in part, or if implementation of certain aspects of the ACA is delayed, such repeal, modification or delay could adversely impact our existing and future business and operating results. For example, any such repeal, modification or delay could negatively impact the revenue we currently generate from our ACA Compliance solution as well as overall gross margins. While we expect continued challenges to the ACA, at this time we are unable to more precisely predict the full impact of any repeal, modification or delay in the implementation of the ACA.

The sale and support of products and the performance of related services by us entail the risk of product or service liability claims, which could significantly affect our financial results.

Clients use our products in connection with the preparation and filing of tax returns and other regulatory reports. If any of our products contain errors that produce inaccurate results upon which users rely, or cause users to misfile or fail to file required information, we could be subject to liability claims from users. Our agreements with our clients typically contain provisions intended to limit our exposure to such claims, but such provisions may not be effective in limiting our exposure. Contractual limitations we use may not be enforceable and may not provide us with adequate protection against product liability claims in certain jurisdictions. A successful claim for product or service liability brought against us could result in substantial cost to us and divert management's attention from our operations.

Privacy concerns and laws or other domestic regulations may increase the cost of our solutions or reduce the effectiveness of our applications and adversely affect our business.

Our clients collect, use and store personal or identifying information regarding their employees and their family members in our solutions. Federal and state government bodies and agencies have adopted, are considering adopting, or may adopt laws and regulations regarding the collection, use, storage and disclosure of such personal information. In addition, HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act, and its implementing regulations, applies to our benefit administration solution, BeneFLEX, as a business associate. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to our clients' businesses may limit the use and adoption of our applications and reduce overall demand, or lead to significant fines, penalties or liabilities for any noncompliance with such privacy laws. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our solutions.

All of these legislative and regulatory initiatives may adversely affect our clients' ability to process, handle, store, use and transmit demographic and personal information regarding their employees and family members, which could reduce demand for our solutions.



In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self-regulatory standards that may place additional burdens on us. If the processing of personal information were to be curtailed in this manner, our products would be less effective, which may reduce demand for our applications and adversely affect our business.

Our business could be adversely affected if we do not effectively implement and service our solutions or if we are unable to accommodate increased demand for our implementation and client services resulting from growth in our business.

Our ability to deliver our payroll and HCM solutions depends on our ability to effectively implement and to transition to, and train our clients on, our solutions. We do not recognize revenue from new clients until they process their first payroll. Further, the majority of our agreements with our clients are generally terminable by the clients on 60 days' or less notice. If a client is not satisfied with our implementation services, the client could terminate its agreement with us before we have recovered our costs of implementation services, which would adversely affect our results of operations and cash flows. In addition, negative publicity related to our client relationships, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective clients.

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Once our applications are deployed, our clients depend on our client service organization to resolve issues relating to our solutions. The majority of our clients are medium-sized organizations with limited personnel and resources to address payroll and other HCM related issues. These clients rely on us more so than larger companies with greater internal resources and expertise. High-quality client services are important for the successful marketing and sale of our products and for the retention of existing clients. If we do not help our clients quickly resolve issues and provide effective ongoing support, our ability to sell additional products to existing clients would suffer and our reputation with existing or potential clients would be harmed. Our sales process is highly dependent on our applications and business reputation and on positive recommendations from our existing clients. Any failure to maintain high-quality client services, or a market perception that we do not maintain high-quality client services, could adversely affect our reputation, our ability to sell our solutions to existing and prospective clients, and our business, operating results and financial position.

In addition, we may be unable to respond quickly enough to accommodate increased client demand for implementation and client services driven by our growth. In order to ensure that we have sufficient employees to implement and service our solutions, we must closely coordinate hiring of personnel with our projected sales for a particular period. Because our sales cycle is typically only three to six weeks long, we may not be successful in coordinating hiring of implementation and client service personnel to meet increased demand for our services. Increased demand for services without a corresponding staffing increase of qualified personnel could adversely affect the quality of services provided to our clients, and our business and our reputation could be harmed.

Our software might not operate properly, which could damage our reputation, give rise to claims against us, or divert application of our resources from other purposes, any of which could harm our business and operating results.

Our payroll and HCM software is complex and may contain or develop undetected defects or errors, particularly when first introduced or as new versions are released. Despite extensive testing, from time to time we have discovered defects or errors in our products. In addition, because changes in employer and legal requirements and practices relating to benefits are frequent, we discover defects and errors in our software and service processes in the normal course of business compared against these requirements and practices. Material performance problems or defects in our products and services might arise in the future, which could have an adverse impact on our business and client relationship and subject us to claims.

Moreover, software development is time-consuming, expensive and complex. Unforeseen difficulties can arise. We might encounter technical obstacles, and it is possible that we discover problems that prevent our products from operating properly. If they do not function reliably or fail to achieve client expectations in terms of performance, clients could cancel their agreements with us and/or assert liability claims against us. This could damage our reputation, impair our ability to attract or maintain clients and harm our results of operations.

Defects and errors and any failure by us to identify and address them could result in delays in product introductions and updates, loss of revenue or market share, liability to clients or others, failure to achieve market acceptance or

expansion, diversion of development and other resources, injury to our reputation, and increased service and maintenance costs. Defects or errors in our product or service processes might discourage existing or potential clients from purchasing from us. Correction of defects or errors could prove to be impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability might be substantial and could adversely affect our operating results.

Because of the large amount of data that we collect and manage, it is possible that hardware failures or errors in our systems could result in data loss or corruption, or cause the information that we collect to be incomplete or contain inaccuracies that our clients, their employees and taxing and other regulatory authorities regard as significant. The costs incurred in correcting any errors or in responding to regulatory authorities or to resulting claims or liability might be substantial and could adversely affect our operating results.

We maintain insurance, but our insurance may be inadequate or may not be available in the future on acceptable terms, or at all. In addition, our policy may not cover all claims made against us and defending a suit, regardless of its merit, could be costly and divert management's attention.

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Our clients might assert claims against us in the future alleging that they suffered damages due to a defect, error, or other failure of our product or service processes. A product liability claim and errors or omissions claim could subject us to significant legal defense costs and adverse publicity regardless of the merits or eventual outcome of such a claim.

Client funds that we hold are subject to market, interest rate, credit and liquidity risks. The loss of these funds could have an adverse impact on our business.

We invest funds held for our clients in liquid, investment-grade marketable securities such as corporate bonds, commercial paper, asset-backed securities, U.S. treasury securities, money market securities, and other cash equivalents. We follow an established client fund investment policy and set of guidelines to monitor and help mitigate our exposure to liquidity and credit risks. Nevertheless, our client fund assets are subject to general market, interest rate, credit, and liquidity risks. These risks may be exacerbated, individually or in unison, during periods of unusual financial market volatility. Any loss of or inability to access client funds could have an adverse impact on our cash position and results of operations and could require us to obtain additional sources of liquidity.

In addition, these funds are held in consolidated accounts on behalf of our clients, and as a result, the aggregate amounts in the accounts exceed the applicable federal deposit insurance limits. We believe that since such funds are deposited in trust on behalf of our clients, the Federal Deposit Insurance Corporation, or the FDIC, would treat those funds as if they had been deposited by each of the clients themselves and insure each client's funds up to the applicable deposit insurance limits. If the FDIC were to take the position that it is not obligated to provide deposit insurance for our clients' funds or if the reimbursement of these funds were delayed, our business and our clients could be materially harmed.

If we are required to collect sales and use taxes in additional jurisdictions, we might be subject to liability for past sales and our future sales may decrease. Adverse tax laws or regulations could be enacted or existing laws could be applied to us or our clients, which could increase the costs of our services and adversely impact our business.

The application of federal, state, and local tax laws to services provided electronically is evolving. New income, sales, use or other tax laws, statutes, rules, regulations or ordinances could be enacted at any time (possibly with retroactive effect), and could be applied solely or disproportionately to services provided over the Internet. These enactments could adversely affect our sales activity due to the inherent cost increase the taxes would represent and ultimately result in a negative impact on our operating results and cash flows.

In addition, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, changed, modified or applied adversely to us (possibly with retroactive effect), which could require us or our clients to pay additional tax amounts, as well as require us or our clients to pay fines or penalties and interest for past amounts.

For example, we might lose sales or incur significant expenses if states successfully impose broader guidelines on state sales and use taxes. A successful assertion by one or more states requiring us to collect sales or other taxes on our software or provision of our services could result in substantial tax liabilities for past transactions and otherwise harm our business. Each state has different rules and regulations governing sales and use taxes, and these rules and regulations are subject to varying interpretations that change over time. We review these rules and regulations periodically and, when we believe we are subject to sales and use taxes in a particular state, we may voluntarily engage state tax authorities in order to determine how to comply with that state's rules and regulations. We cannot assure you that we will not be subject to sales and use taxes or related penalties for past sales in states where we currently believe no such taxes are required.

Vendors of services, like us, are typically held responsible by taxing authorities for the collection and payment of any applicable sales and similar taxes. If one or more taxing authorities determines that taxes should have, but have not, been paid with respect to our services, we might be liable for past taxes in addition to taxes going forward. Liability for past taxes might also include substantial interest and penalty charges. Our clients typically pay us for applicable sales and similar taxes. Nevertheless, our clients might be reluctant to pay back taxes and might refuse responsibility for interest or penalties associated with those taxes. If we are required to collect and pay back taxes and the associated

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interest and penalties, and if our clients fail or refuse to reimburse us for all or a portion of these amounts, we will incur unplanned expenses that may be substantial. Moreover, imposition of such taxes on us going forward will effectively increase the cost of our services to our clients and might adversely affect our ability to retain existing clients or to gain new clients in the areas in which such taxes are imposed.

We may experience negative or unforeseen tax consequences.

In December 2017, both houses of the U.S. Congress passed legislation, known as the Tax Cuts and Jobs Act of 2017, that was approved and signed into law. This legislation could have a material benefit or material adverse impact on our effective tax rate, tax expense and cash flow. We are in the process of evaluating the potential aggregate impact the enactment of this passed legislation will have on our financial condition, cash flows and results of operations. Any benefits associated with lower U.S. corporate tax rates could be reduced or offset by other tax changes adverse to our business or operations.

Any future litigation against us could be costly and time-consuming to defend.

We may become subject, from time to time, to legal proceedings and claims that arise in the ordinary course of business such as claims brought by our clients in connection with commercial disputes, employment claims made by our current or former employees, or lawsuits related to breaches of personal information. Litigation might result in substantial costs and may divert management's attention and resources, which might seriously harm our business, overall financial condition, and operating results. Insurance might not cover such claims, might not provide sufficient payments to cover all the costs to resolve one or more such claims and might not continue to be available on terms acceptable to us. A claim brought against us that is uninsured or underinsured could result in unanticipated costs, thereby harming our operating results and leading analysts or potential investors to lower their expectations of our performance, which could reduce the trading price of our stock.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success is dependent, in part, upon protecting our proprietary technology. We rely on a combination of copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and protect our proprietary rights in our products and services. Our proprietary technologies are not covered by any patent or patent application. However, the steps we take to protect our intellectual property may be inadequate. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Despite our precautions, it may be possible for unauthorized third parties to copy our products and use information that we regard as proprietary to create products and services that compete with ours. Some license provisions protecting against unauthorized use, copying, transfer and disclosure of our products may be unenforceable

under the laws of certain jurisdictions and foreign countries.

We enter into confidentiality and invention assignment agreements with our employees and consultants and enter into confidentiality agreements with the parties with whom we have strategic relationships and business alliances. No assurance can be given that these agreements will be effective in controlling access to and distribution of our products and proprietary information. The confidentiality agreements on which we rely to protect certain technologies may be breached and may not be adequate to protect our proprietary technologies. Further, these agreements do not prevent our competitors from independently developing technologies that are substantially equivalent or superior to our solutions. In addition, we depend, in part, on technology of third parties licensed to us for our solutions, and the loss or inability to maintain these licenses or errors in the software we license could result in increased costs, reduced service levels or delayed sales of our solutions.

In order to protect our intellectual property rights, we may be required to spend significant resources to monitor and protect these rights. Litigation may be necessary in the future to enforce our intellectual property rights and to protect our trade secrets. Litigation brought to protect and enforce our intellectual property rights could be costly, time consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims

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and countersuits attacking the validity and enforceability of our intellectual property rights. Our inability to protect our proprietary technology against unauthorized copying or use, as well as any costly litigation or diversion of our management's attention and resources, could delay further sales or the implementation of our solutions, impair the functionality of our solutions, delay introductions of new solutions, result in our substituting inferior or more costly technologies into our solutions, or injure our reputation. In addition, we may be required to license additional technology from third parties to develop and market new solutions, and we cannot assure you that we could license that technology on commercially reasonable terms, or at all. Although we do not expect that our inability to license this technology in the future would have a material adverse effect on our business or operating results, our inability to license this technology could adversely affect our ability to compete.

We may be sued by third parties for alleged infringement of their proprietary rights.

There is considerable patent and other intellectual property development activity in our industry. Our success depends, in part, upon our not infringing upon the intellectual property rights of others. Our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry. From time to time, third parties may claim that we are infringing upon their intellectual property rights, and we may be found to be infringing upon such rights. In the future, others may claim that our applications and underlying technology infringe or violate their intellectual property rights. However, we may be unaware of the intellectual property rights that others may claim cover some or all of our technology or services. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our services, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our clients or business partners or pay substantial settlement costs, including royalty payments, in connection with any such claim or litigation and to obtain licenses, modify applications, or refund fees, which could be costly. Even if we were to prevail in such a dispute, any litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations.

The use of open source software in our products and solutions may expose us to additional risks and harm our intellectual property rights.

Some of our products and solutions use or incorporate software that is subject to one or more open source licenses. Open source software is typically freely accessible, usable and modifiable. Certain open source software licenses require a user who intends to distribute the open source software as a component of the user's software to disclose publicly part or all of the source code to the user's software. In addition, certain open source software licenses require the user of such software to make any derivative works of the open source code available to others on potentially unfavorable terms or at no cost.

The terms of many open source licenses to which we are subject have not been interpreted by U.S. or foreign courts. Accordingly, there is a risk that those licenses could be construed in a manner that imposes unanticipated conditions



or restrictions on our ability to commercialize our solutions. In that event, we could be required to seek licenses from third parties in order to continue offering our products or solutions, to re-develop our products or solutions, to discontinue sales of our products or solutions, or to release our proprietary software code under the terms of an open source license, any of which could harm our business. Further, given the nature of open source software, it may be more likely that third parties might assert copyright and other intellectual property infringement claims against us based on our use of these open source software programs.

While we monitor the use of all open source software in our products, solutions, processes and technology and try to ensure that no open source software is used in such a way as to require us to disclose the source code to the related product or solution when we do not wish to do so, it is possible that such use may have inadvertently occurred in deploying our proprietary solutions. In addition, if a third-party software provider has incorporated certain types of open source software into software we license from such third party for our products and solutions without our knowledge, we could, under certain circumstances, be required to disclose the source code to our products and solutions. This could harm our intellectual property position and our business, results of operations and financial condition.

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If third-party software used in our products is not adequately maintained or updated, our business could be materially adversely affected.

Our products utilize certain software of third-party software developers. For example, we license technology from bswift as part of our Paylocity Enterprise Benefits solution. Although we believe that there are alternatives for these products, any significant interruption in the availability of such third-party software could have an adverse impact on our business unless and until we can replace the functionality provided by these products at a similar cost. Additionally, we rely, to a certain extent, upon such third parties' abilities to enhance their current products, to develop new products on a timely and cost-effective basis and to respond to emerging industry standards and other technological changes. We may be unable to replace the functionality provided by the third-party software currently offered in conjunction with our products in the event that such software becomes obsolete or incompatible with future versions of our products or is otherwise not adequately maintained or updated.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our applications, and could have a negative impact on our business.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business applications. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the Internet as a commercial medium. Changes in these laws or regulations could require us to modify our applications in order to comply with these changes. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, resulting in reductions in the demand for Internet-based applications such as ours.

In addition, the use of the Internet as a business tool could be adversely affected due to delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, reliability, cost, ease of use, accessibility, and quality of service. The performance of the Internet and its acceptance as a business tool has been adversely affected by "viruses," "worms" and similar malicious programs, and the Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure. If the use of the Internet is adversely affected by these issues, demand for our applications could suffer.

Furthermore, the availability or performance of our applications could be adversely affected by a number of factors, including clients' inability to access the Internet, the failure of our network or software systems, security breaches or variability in user traffic for our services. For example, our clients access our solutions through their Internet service providers. If a service provider fails to provide sufficient capacity to support our applications or otherwise experiences service outages, such failure could interrupt our clients' access to our solutions, adversely affect their perception of our applications' reliability and reduce our revenues. In addition to potential liability, if we experience interruptions in the availability of our applications, our reputation could be adversely affected and we could lose clients.

Regulatory requirements placed on our software and services could impose increased costs on us, delay or prevent our introduction of new products and services, and impair the function or value of our existing products and services.

Our products and services may become subject to increasing regulatory requirements, and as these requirements proliferate, we may be required to change or adapt our products and services to comply. Changing regulatory requirements might render our products and services obsolete or might block us from developing new products and services. This might in turn impose additional costs upon us to comply or to further develop our products and services. It might also make introduction of new products and services more costly or more time-consuming than we currently anticipate. It might even prevent introduction by us of new products or services or cause the continuation of our existing products or services to become more costly.

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We might require additional capital to support business growth, and this capital might not be available.

We intend to continue to make investments to support our business growth and might require additional funds to respond to business challenges or opportunities, including the need to develop new products and services or enhance our existing services, enhance our operating infrastructure, and acquire complementary businesses and technologies. Accordingly, we might need to engage in equity or debt financings to secure additional funds. In addition, we will need to expand our ACH capacity as we grow our business.

If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing or ACH facility secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which might make it more difficult for us to obtain additional capital and to pursue business opportunities and to grow our business. In addition, we might not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

Our services present the potential for embezzlement, identity theft, or other similar illegal behavior by our associates with respect to third parties.

Certain services offered by us involve collecting payroll information from individuals, and this frequently includes information about their checking accounts. Our services also involve the use and disclosure of personal and business information that could be used to impersonate third parties, commit identity theft, or otherwise gain access to their data or funds. If any of our associates take, convert, or misuse such funds, documents or data, we could be liable for damages, and our business reputation could be damaged or destroyed. Moreover, if we fail to adequately prevent third parties from accessing personal and/or business information and using that information to commit identity theft, we might face legal liabilities and other losses than can have a negative impact on our business.

We rely on a third-party shipping provider to deliver printed checks to our clients, and therefore our business could be negatively impacted by disruptions in the operations of this third-party provider.

We rely on third-party couriers such as the United Parcel Service, or UPS, to ship printed checks to our clients. Relying on UPS and other third-party couriers puts us at risk from disruptions in their operations, such as employee strikes, inclement weather and their ability to perform tasks on our behalf. If UPS or other third-party couriers fail to perform their tasks, we could incur liability or suffer damages to our reputation, or both. If we are forced to use other third-party couriers, our costs could increase and we may not be able to meet shipment deadlines. Moreover, we may not be able to obtain terms as favorable as those we currently use, which could further increase our costs. These

circumstances may negatively impact our business, financial condition and results of operations.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board, or FASB, the Securities and Exchange Commission, or SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results including increased volatility, and could affect the reporting of transactions completed before the announcement of a change. Our accounting policies that have been or may be affected by changes in accounting principles include, but are not limited to, revenue recognition and accounting for leases.

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We may acquire other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and adversely affect our operating results.

We have acquired and may in the future seek to acquire or invest in other businesses or technologies. The pursuit of potential acquisitions or investments may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

In addition, we have limited experience in acquiring other businesses. We may not be able to integrate the acquired personnel, operations and technologies successfully, or effectively manage the combined business following the acquisition. We also may not achieve the anticipated benefits from the acquired business due to a number of factors, including:

- Inability to integrate or benefit from acquired technologies or services in a profitable manner;
- Unanticipated costs or liabilities associated with the acquisition;
- Incurrence of acquisition-related costs;
- Difficulty integrating the accounting systems, operations and personnel of the acquired business;
- Difficulties and additional expenses associated with supporting legacy products and hosting infrastructure of the acquired business;
- Difficulty converting the clients of the acquired business onto our applications and contract terms, including disparities in the revenues, licensing, support or professional services model of the acquired company;
- Diversion of management's attention from other business concerns;
- Adverse effects to our existing business relationships with business partners and clients as a result of the acquisition;
- The potential loss of key employees;
- Use of resources that are needed in other parts of our business; and

- Use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could adversely affect our results of operations.

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial position may suffer.

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Risks Related to Ownership of Our Common Stock

Insiders have substantial control over us, which may limit our stockholders' ability to influence corporate matters and delay or prevent a third party from acquiring control over us.

As of August 3, 2018, our directors, executive officers and holders of more than 5% of our common stock, together with their respective affiliates, beneficially owned, in the aggregate, approximately 40.7% of our outstanding common stock. This significant concentration of ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. In addition, these stockholders will be able to exercise influence over all matters requiring stockholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit the ability of our other stockholders to influence corporate matters and may have the effect of delaying or preventing a change in control, including a merger, consolidation, or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if that change in control would benefit our other stockholders.

Our stock price may be subject to wide fluctuations.

The trading price of our common stock could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include those discussed in this "Risk Factors" section of this Annual Report on Form 10-K and others such as:

- Our operating performance and the operating performance of similar companies;
  - Announcements by us or our competitors of acquisitions, business plans or commercial relationships;
- Any major change in our board of directors or senior management;
- Publication of research reports or news stories about us, our competitors, or our industry, or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- The public's reaction to our press releases, our other public announcements and our filings with the SEC;



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- Sales of our common stock by our directors, executive officers and affiliates;
- Adverse market reaction to any indebtedness we may incur or securities we may issue in the future;
- Short sales, hedging and other derivative transactions in our common stock;
- Our share repurchase program;
- Threatened or actual litigation;
- Our recently announced share repurchase program may not be fully consummated or may not enhance shareholder value, and trading prices of our common stock may be impacted; and
- Other events or factors, including changes in general conditions in the United States and global economies or financial markets (including acts of God, war, incidents of terrorism, or other destabilizing events and the resulting responses to them).

In addition, the stock market in general and the market for Internet-related companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following

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periods of volatility in the overall market and in the market price of a company's securities. This litigation, if instituted against us, could result in substantial costs, divert our management's attention and resources, and harm our business, operating results, and financial condition.

We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.

We have not declared or paid dividends on our common stock in the past three fiscal years and do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings to fund our growth and other corporate initiatives. Therefore, you are not likely to receive any dividends on your common stock for the foreseeable future, and the success of an investment in shares of our common stock will depend upon future appreciation in its value, if any. There is no guarantee that shares of our common stock will appreciate in value or even maintain the price at which our stockholders purchased their shares.

Future sales of shares of our common stock by existing stockholders could depress the market price of our common stock.

As of August 3, 2018, we had an aggregate of 52,767,163 outstanding shares of common stock. The 17,362,750 shares sold in our initial public offering, follow-on offering and secondary offering can be freely sold in the public market without restriction. The remaining shares can be freely sold in the public market, subject in some cases to volume and other restrictions under Rule 144 and 701 under the Securities Act of 1933, as amended, and various agreements.

In addition, we have registered 17,853,893 shares of common stock that we have issued and may issue under our equity plans. These shares can be freely sold in the public market upon issuance, subject in some cases to volume and other restrictions under Rules 144 and 701 under the Securities Act, and various vesting agreements. In addition, some of our employees, including some of our executive officers, have entered into 10b5-1 trading plans regarding sales of shares of our common stock. These plans provide for sales to occur from time to time. If any of these additional shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

Also, in the future, we may issue additional securities in connection with investments and acquisitions. The amount of our common stock issued in connection with an investment or acquisition could constitute a material portion of our then outstanding stock. Due to these factors, sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the perception in the market that the holders of a large number of shares intend to sell shares, could reduce the market price of our common stock.

If we are unable to maintain effective internal controls over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may be negatively affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires that we evaluate and determine the effectiveness of our internal controls over financial reporting and provide a management report on the internal controls over financial reporting. In addition, the Sarbanes-Oxley Act requires that our management report on the internal controls over financial reporting be attested to by our independent registered public accounting firm. If we have a material weakness in our internal controls over financial reporting, we may not detect errors on a timely basis and our financial statements may be materially misstated. Compliance with these public company requirements has made some activities more time-consuming, costly and complicated. If we identify material weaknesses in our internal controls over financial reporting, if we are unable to assert that our internal controls over financial reporting are effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal controls over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected, and we could become subject to investigations by the stock exchange on which our securities are listed, the SEC or other regulatory authorities, which could require additional financial and management resources.

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We have incurred and will continue to incur significantly increased costs and devote substantial management time as a result of operating as a public company.

As a public company, we have incurred and will continue to incur significant legal, accounting and other expenses. For example, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and are required to comply with the applicable requirements of the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as rules and regulations subsequently implemented by the SEC and the NASDAQ Global Select Market including the establishment and maintenance of effective disclosure and financial controls and changes in corporate governance practices. Compliance with these requirements has increased our legal and financial compliance costs and has made some activities more time consuming and costly. In addition, our management and other personnel have been required to divert attention from operational and other business matters to devote substantial time to these public company requirements. In particular, we have incurred and will continue to incur significant expenses as well as devote substantial management effort toward ensuring ongoing compliance with the requirements of Section 404 of the Sarbanes-Oxley Act. Although we have hired additional employees to comply with these requirements, we may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge to comply with any regulatory changes.

If securities or industry analysts do not continue to publish research or publish unfavorable or misleading research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who covers us downgrades our stock or publishes unfavorable or misleading research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, we could lose visibility in the market for our stock and demand for our stock could decrease, which could cause our stock price or trading volume to decline.

Anti-takeover provisions in our charter documents and Delaware law could discourage, delay, or prevent a change in control of our company and may affect the trading price of our common stock.

We are a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law, which apply to us, may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the stockholder becomes an interested stockholder, even if a change in control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a change in our management or control over us that stockholders may consider favorable. Our amended and restated certificate of incorporation and bylaws:

- Authorize the issuance of “blank check” convertible preferred stock that could be issued by our board of directors to thwart a takeover attempt;
- Establish a classified board of directors, as a result of which the successors to the directors whose terms have expired will be elected to serve from the time of election and qualification until the third annual meeting following their election;
- Require that directors only be removed from office for cause and only upon a supermajority stockholder vote;
- Provide that vacancies on the board of directors, including newly-created directorships, may be filled only by a majority vote of directors then in office rather than by stockholders;
- Prevent stockholders from calling special meetings; and
- Prohibit stockholder action by written consent, requiring all actions to be taken at a meeting of the stockholders.

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Our bylaws provide that the state and federal courts located within the state of Delaware are the sole and exclusive forums for certain legal actions involving the company or our directors, officers and employees.

On February 2, 2016, we amended our bylaws to designate the state and federal courts located within the state of Delaware as the sole and exclusive forums for claims arising derivatively, pursuant to the Delaware General Corporation Law or governed by the internal affairs doctrine. The choice of forum provision is expressly authorized by the Delaware General Corporation Law, which was amended so that companies would not have to litigate internal claims in more than one jurisdiction. If a court were to find the exclusive forum provision contained in our bylaws to be inapplicable or unenforceable, we may incur additional costs associated with resolving such extra-forum claims, which could adversely affect our business and financial condition. This bylaws provision, therefore, may dissuade or discourage claimants from initiating lawsuits or claims against us or our directors and officers in forums other than Delaware.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of June 30, 2018, our corporate headquarters occupied approximately 200,000 square feet in Schaumburg, Illinois under leases with final expiration in October 2032. As of June 30, 2018, we also leased facilities in Arlington Heights, Illinois; Rochester, New York; New York, New York; Lake Mary, Florida; Nashua, New Hampshire; Springfield, New Jersey; Boise, Idaho; Meridian, Idaho; Irvine, California; Oakland, California; Novi, Michigan and Sunset Hills, Missouri.

In June 2016, we entered into a lease for approximately 309,559 rentable square feet of office space located in Schaumburg, Illinois. We currently utilize the leased premises as our headquarters, having relocated from our previous headquarters in Arlington Heights, Illinois in the fourth quarter of fiscal 2018. The lease provided for phased delivery and commencement dates, and we commenced the first three phases on the following dates: Phase I (June 1, 2017), Phase II (November 1, 2017) and Phase III (July 1, 2018). We expect to commence Phase IV on July 1, 2019 with the actual commencement date subject to timely delivery of the premises by the landlord. The lease began on the Phase I commencement date (June 1, 2017) and will end on October 31, 2032 with two subsequent five-year renewal options.

In February 2017, we entered into a lease for approximately 62,000 rentable square feet of office space located in Meridian, Idaho. We use the leased premises to accommodate the continued expansion of our employee base in the western region of the United States. The lease provided for phased delivery and commencement dates, and we

commenced Phase I on July 2, 2018. We expect to commence Phase II on February 1, 2020 with the actual commencement date subject to timely delivery of the premises by the landlord. The lease began on the Phase I commencement date (July 2, 2018) and will end on July 31, 2028 with four subsequent five-year renewal options.

For additional information regarding obligations under operating leases, see Note 10 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

### Item 3. Legal Proceedings.

From time to time, we may become involved in litigation related to claims arising from the ordinary course of our business. We believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

### Item 4. Mine Safety Disclosures.

Not applicable.

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## PART II

## Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our common stock is listed on the NASDAQ Global Select Market under the symbol “PCTY”. The following table sets forth for the periods indicated the high and low intra-day sale prices per share of our common stock as reported on the NASDAQ Global Select Market:

	High	Low
Year ended June 30, 2017		
First Quarter	\$ 47.27	\$ 41.47
Second Quarter	\$ 46.02	\$ 30.01
Third Quarter	\$ 39.51	\$ 29.92
Fourth Quarter	\$ 49.16	\$ 37.93
Year ended June 30, 2018		
First Quarter	\$ 49.49	\$ 42.54
Second Quarter	\$ 53.96	\$ 44.11
Third Quarter	\$ 57.16	\$ 41.15
Fourth Quarter	\$ 64.21	\$ 47.29

On August 3, 2018, the last reported sale price of our common stock on the NASDAQ Global Select Market was \$62.44 per share, and there were 17 holders of record of our common stock. The actual number of holders of common stock is greater than these numbers of record holders and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and nominees. The number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

## Use of Proceeds from Initial Public Offering of Common Stock

On March 24, 2014, we completed our initial public offering, or IPO, of 8,101,750 shares of common stock, at a price of \$17.00 per share, before underwriting discounts and commissions. We sold 5,366,667 of such shares and existing shareholders sold an aggregate of 2,735,083 of such shares. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-193661), which was



declared effective by the SEC on March 18, 2014.

With the proceeds of the IPO, we repaid amounts outstanding under a note issued by us to Commerce Bank & Trust Company on March 9, 2011, which totaled \$1.1 million, paid \$9.4 million for the purchase of substantially all of the assets of BFKMS Inc., and paid \$9.5 million for the purchase of substantially all of the assets of Synergy Payroll LLC.

#### Use of Proceeds from Follow-On Offering of Common Stock

On December 17, 2014, we completed a follow-on offering of 4,960,000 shares of common stock at a price of \$26.25 per share, before underwriting discounts and commissions. We sold 750,000 of such shares and existing shareholders sold an aggregate of 4,210,000 of such shares. The offer and sale of all of the shares in the follow-on offering were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-200448) which was declared effective by the SEC on December 11, 2014. There have been no material changes in the planned use of proceeds from the follow-on offering as described in the final prospectus filed with the SEC pursuant to Rule 424(b) on December 12, 2014.

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### Use of Proceeds from Secondary Offering of Common Stock

On September 30, 2015, we completed a secondary offering of 4,301,000 shares of common stock at a price of \$29.75 per share, before underwriting discounts and commissions. The offer and sale of all of the shares in the secondary offering were registered under the Securities Act pursuant to a registration statement on Form S-3 (File No. 333-206941) which was declared effective by the SEC on September 25, 2015. The Company did not receive any proceeds from the sale of common stock, as all the shares were sold by shareholders of the Company.

### Dividend Policy

We have not declared or paid dividends on our common stock since our IPO. Neither Delaware law nor our amended and restated certificate of incorporation requires our board of directors to declare dividends on our common stock. Any future determination to declare cash dividends on our common stock will be made at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements, general business conditions and other factors that our board of directors may deem relevant. We do not anticipate paying cash dividends on our common stock for the foreseeable future.

### Equity Compensation Plan Information

Information regarding the securities authorized for issuance under our equity compensation plans will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

### Performance Graph

Notwithstanding any statement to the contrary in any of our filings with the SEC, the following information shall not be deemed “filed” with the SEC or “soliciting material” under the Securities Exchange Act of 1934 and shall not be incorporated by reference into any such filings irrespective of any general incorporation language contained in such filing.

The following graph compares the total cumulative stockholder return on our common stock with the total cumulative return of the S&P 500 Index and the S&P 1500 Application Software Index during the period commencing on March 19, 2014, the initial trading day of our common stock, and ending on June 30, 2018. The graph assumes that \$100 was

invested at the beginning of the period in our common stock and in each of the comparative indices, and the

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reinvestment of any dividends. Historical stock price performance should not be relied upon as an indication of future stock price performance.

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## Item 6. Selected Financial Data.

## Consolidated Selected Financial Data

You should read the following selected consolidated financial data together with our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K and the information under the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Our fiscal year ends on June 30. The statements of operations data presented below have been derived from our audited consolidated financial statements. Historical results are not necessarily indicative of future results.

	Year Ended June 30,				
	2014	2015	2016	2017	2018
	(in thousands, except per share data)				
Consolidated Statements of Operations					
Data:					
Revenues:					
Recurring fees	\$ 100,362	\$ 142,168	\$ 217,416	\$ 284,817	\$ 354,432
Interest income on funds held for clients	1,582	1,901	2,688	3,631	9,093
Total recurring revenues	101,944	144,069	220,104	288,448	363,525
Implementation services and other	6,743	8,629	10,597	11,562	14,002
Total revenues	108,687	152,698	230,701	300,010	377,527
Cost of revenues:					
Recurring revenues	37,319	46,366	66,131	85,399	104,009
Implementation services and other	17,775	24,530	31,954	38,588	45,188
Total cost of revenues	55,094	70,896	98,085	123,987	149,197
Gross profit	53,593	81,802	132,616	176,023	228,330
Operating expenses:					
Sales and marketing	28,276	43,035	61,832	77,506	95,484
Research and development	10,355	19,864	26,736	29,098	37,645
General and administrative	21,980	32,824	47,598	62,123	79,252
Total operating expenses	60,611	95,723	136,166	168,727	212,381
Operating income (loss)	(7,018)	(13,921)	(3,550)	7,296	15,949
Other income (expense)	163	54	(124)	73	802
Income (loss) before income taxes	(6,855)	(13,867)	(3,674)	7,369	16,751
Income tax expense (benefit)	255	105	177	651	(21,847)
Net income (loss)	\$ (7,110)	\$ (13,972)	\$ (3,851)	\$ 6,718	\$ 38,598
Net income (loss) attributable to common stockholders	\$ (9,392)	\$ (13,972)	\$ (3,851)	\$ 6,718	\$ 38,598
Net income (loss) per share attributable to common stockholders:					
Basic	\$ (0.26)	\$ (0.28)	\$ (0.08)	\$ 0.13	\$ 0.74
Diluted	\$ (0.26)	\$ (0.28)	\$ (0.08)	\$ 0.12	\$ 0.70

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Weighted average shares used in  
computing net income (loss) per share  
attributable to common stockholders:

Basic	36,707	50,127	50,913	51,415	52,425
Diluted	36,707	50,127	50,913	54,057	54,887
Other Financial Data:					
Adjusted Gross Profit(1)	\$ 57,029	\$ 87,226	\$ 141,029	\$ 189,272	\$ 247,193
Adjusted Recurring Gross Profit(1)	\$ 67,458	\$ 101,876	\$ 161,184	\$ 214,825	\$ 276,857
Adjusted EBITDA(1)	\$ 5,448	\$ 8,238	\$ 28,398	\$ 56,190	\$ 81,297

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	As of June 30, 2014 (in thousands)	2015	2016	2017	2018
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 78,848	\$ 81,258	\$ 86,496	\$ 103,468	\$ 137,193
Working capital(2)	67,137	69,296	68,986	88,040	107,395
Funds held for clients	417,261	591,219	1,239,622	942,459	1,225,614
Total assets	528,151	720,548	1,390,689	1,137,441	1,507,599
Client fund obligations	417,261	591,219	1,239,622	942,459	1,225,614
Stockholders' equity	91,134	107,580	119,572	147,613	212,824

(1) We use Adjusted Gross Profit, Adjusted Recurring Gross Profit, and Adjusted EBITDA to evaluate our operating results. We prepare Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA to eliminate the impact of items we do not consider indicative of our ongoing operating performance. However, Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA are not measurements of financial performance under generally accepted accounting principles in the United States, or GAAP, and these metrics may not be comparable to similarly-titled measures of other companies.

We define Adjusted Gross Profit as gross profit before amortization of capitalized internal-use software costs, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises and one-time founder funded bonus pay-outs, if any. We define Adjusted Recurring Gross Profit as total recurring revenues after cost of recurring revenues and before amortization of capitalized internal-use software costs, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises and one-time founder funded bonus pay-outs, if any. We define Adjusted EBITDA as net income (loss) before interest expense, income tax expense (benefit), depreciation and amortization expense, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises, one-time founder funded bonus pay-outs, if any, acquisition-related costs and lease exit costs.

We disclose Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA, which are non-GAAP measures, because we believe these metrics assist investors and analysts in comparing our performance across reporting periods on a consistent basis by excluding items that we do not believe are indicative of our core operating performance. We believe these metrics are commonly used in the financial community to aid in comparisons of similar companies, and we present them to enhance investors' understanding of our operating performance and cash flows.

Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA have limitations as analytical tools. Some of these limitations are:

- Adjusted EBITDA does not reflect our ongoing or future requirements for capital expenditures;

- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect our income tax expense or the cash requirement to pay our taxes;
- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;  
and
- Other companies in our industry may calculate Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA differently than we do, limiting their usefulness as a comparative measure.

Additionally, stock-based compensation will continue to be an element of our overall compensation strategy, although we exclude it from Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA as an expense when evaluating our ongoing operating performance for a particular period.



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Because of these limitations, you should not consider Adjusted Gross Profit as an alternative to gross profit, Adjusted Recurring Gross Profit as an alternative to total recurring revenues, or Adjusted EBITDA as an alternative to net income (loss) or net cash provided by operating activities, in each case as determined in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results, and we use Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA only as supplemental information.

Directly comparable GAAP measures to Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA are gross profit, total recurring revenues and net income (loss), respectively. We reconcile Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA as follows:

	Year Ended June 30,				
	2014	2015	2016	2017	2018
	(in thousands)				
Reconciliation from Gross Profit to Adjusted Gross Profit					
Gross profit	\$ 53,593	\$ 81,802	\$ 132,616	\$ 176,023	\$ 228,330
Amortization of capitalized internal-use software costs	2,195	2,606	5,446	9,447	14,315
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	920	2,818	2,967	3,802	4,548
One-time founder funded bonus pay-outs	321	—	—	—	—
Adjusted Gross Profit	\$ 57,029	\$ 87,226	\$ 141,029	\$ 189,272	\$ 247,193

	Year Ended June 30,				
	2014	2015	2016	2017	2018
	(in thousands)				
Reconciliation from Total Recurring Revenues to Adjusted Recurring Gross Profit					
Total recurring revenues	\$ 101,944	\$ 144,069	\$ 220,104	\$ 288,448	\$ 363,525
Cost of recurring revenues	(37,319)	(46,366)	(66,131)	(85,399)	(104,009)
Recurring gross profit	64,625	97,703	153,973	203,049	259,516
Amortization of capitalized internal-use software costs	2,195	2,606	5,446	9,447	14,315
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	496	1,567	1,765	2,329	3,026
One-time founder funded bonus pay-outs	142	—	—	—	—
Adjusted Recurring Gross Profit	\$ 67,458	\$ 101,876	\$ 161,184	\$ 214,825	\$ 276,857

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	Year Ended June 30,				
	2014	2015	2016	2017	2018
	(in thousands)				
Reconciliation from Net Income (Loss) to Adjusted EBITDA					
Net Income (Loss)	\$ (7,110)	\$ (13,972)	\$ (3,851)	\$ 6,718	\$ 38,598
Interest expense	67	—	—	—	—
Income tax expense (benefit)	255	105	177	651	(21,847)
Depreciation and amortization expense	6,336	8,609	13,873	21,027	30,202
EBITDA	(452)	(5,258)	10,199	28,396	46,953
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	4,929	13,496	18,199	27,794	31,817
One-time founder funded bonus pay-outs	971	—	—	—	—
Acquisition-related costs	—	—	—	—	191
Lease exit costs	—	—	—	—	2,336
Adjusted EBITDA	\$ 5,448	\$ 8,238	\$ 28,398	\$ 56,190	\$ 81,297

(2) Working capital is defined as total current assets minus total current liabilities.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The statements included herein that are not based solely on historical facts are "forward looking statements." Such forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties. Our actual results could differ materially from those anticipated by us in these forward-looking statements as a result of various factors, including those discussed below and under Part I, Item 1A. "Risk Factors."

Overview

We are a cloud-based provider of payroll and human capital management ("HCM") software solutions for medium-sized organizations, which we define as those having between 20 and 1,000 employees. Our comprehensive and easy-to-use solutions enable our clients to manage their workforces more effectively. Our solutions help drive strategic human capital decision-making and improve employee engagement by enhancing the human resource, payroll and finance capabilities of our clients.

Effective management of human capital is a core function in all organizations and requires a significant commitment of resources. Medium-sized organizations operating without the infrastructure, expertise or personnel of larger enterprises are uniquely pressured to manage their human capital effectively.

Our solutions were specifically designed to meet the payroll and HCM needs of medium-sized organizations. We designed our cloud-based platform to provide a unified suite of applications using a multi-tenant architecture. Our solutions are highly flexible and configurable and feature a modern, intuitive user experience. Our platform offers automated data integration with over 300 related third-party systems, such as 401(k), benefits and insurance provider systems.

Our Paylocity Web Pay product is our core payroll solution and was the first of our current offerings introduced into the market. We believe payroll is the most critical system of record for medium-sized organizations and an essential gateway to other HCM functionalities. We have invested in, and we intend to continue to invest in, research and development to expand our product offerings and advance our platform.

We believe there is a significant opportunity to grow our business by increasing our number of clients and we intend to invest in our business to achieve this purpose. We market and sell our solutions primarily through our direct sales force. We have increased our sales and marketing expenses as we have added sales representatives and related sales and marketing personnel. We intend to continue to grow our sales and marketing organization across new and existing geographic territories. In addition to growing our number of clients, we intend to grow our revenue over the long term

by increasing the number and quality of products that clients purchase from us. To do so, we must continue to enhance and grow the number of solutions we offer to advance our platform.

We believe that delivering a positive service experience is an essential element of our ability to sell our solutions and retain our clients. We seek to develop deep relationships with our clients through our unified service model, which has been designed to meet the service needs of mid-market organizations. We expect to continue to invest in and grow our implementation and client service organization as our client base grows.

We believe we have the opportunity to continue to grow our business over the long term, and to do so we have invested, and intend to continue to invest, across our entire organization. These investments include increasing the number of personnel across all functional areas, along with improving our solutions and infrastructure to support our growth. The timing and amount of these investments vary based on the rate at which we add new clients, add new personnel and scale our application development and other activities. Many of these investments will occur in advance of experiencing any direct benefit from them, which will make it difficult to determine if we are effectively allocating our resources. We expect these investments to increase our costs on an absolute basis, but as we grow our number of clients and our related revenues, we anticipate that we will gain economies of scale and increased operating leverage. As a result, we expect our gross and operating margins will improve over the long term.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. If general economic conditions were to deteriorate, including declines in

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private sector employment growth and business productivity, increases in the unemployment rate and changes in interest rates, we may experience delays in our sales cycles, increased pressure from prospective customers to offer discounts and increased pressure from existing customers to renew expiring recurring revenue agreements for lower amounts.

Paylocity Holding Corporation is a Delaware corporation, which was formed in November 2013. Our business operations, excluding interest earned on certain cash holdings and expenses associated with certain secondary stock offerings, have historically been, and are currently, conducted by its wholly owned subsidiaries, and the financial results presented herein are entirely attributable to the results of its operations.

## Key Metrics

We regularly review a number of metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

### Recurring Revenue Growth

Our recurring revenue model and high annual revenue retention rates provide significant visibility into our future operating results and cash flow from operations. This visibility enables us to better manage and invest in our business. Recurring revenue, which is comprised of recurring fees and interest income on funds held for clients, increased from \$220.1 million in fiscal 2016 to \$288.4 million in fiscal 2017, representing a 31% year-over-year increase. Recurring revenue increased from \$288.4 million in fiscal 2017 to \$363.5 million in fiscal 2018, representing a 26% year-over-year increase. Recurring revenue was positively impacted by the launch in fiscal 2016 of our Affordable Care Act (“ACA”) compliance solution, which had significant penetration beginning in the second quarter of fiscal 2016. The impact on year-over-year revenue growth of our ACA compliance solution was the highest in the first quarter of fiscal 2017. Recurring revenue represented 95% of total revenue in fiscal 2016 and 96% of total revenue in fiscal 2017 and 2018.

### Client Count Growth

We believe there is a significant opportunity to grow our business by increasing our number of clients. Excluding clients acquired as part of the BeneFLEX acquisition, we have increased the number of clients using our payroll and HCM software solutions from approximately 12,500 as of June 30, 2016 to approximately 16,700 as of June 30, 2018, representing a compound annual growth rate of approximately 16%. The table below sets forth the total number of clients using our payroll and HCM software solutions for the periods indicated, rounded to the nearest fifty.

	Year Ended June 30,		
	2016	2017	2018
Client Count	12,500	14,550	16,700

The rate at which we add clients is highly variable period-to-period and highly seasonal as many clients switch solutions during the first calendar quarter of each year. Although many clients have multiple divisions, segments or locations, we only count such clients once for these purposes.

#### Annual Revenue Retention Rate

Our annual revenue retention rate has been in excess of 92% during each of the past three fiscal years. We calculate our annual revenue retention rate as our total revenue for the preceding 12 months, less the annualized value of revenue lost during the preceding 12 months, divided by our total revenue for the preceding 12 months. We calculate the annualized value of revenue lost by summing the recurring fees paid by lost clients over the previous twelve months prior to their termination if they have been a client for a minimum of twelve months. For those lost clients who became clients within the last twelve months, we sum the recurring fees for the period that they have been a client and then annualize the amount. We exclude interest income on funds held for clients from the revenue retention calculation. We

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believe that our annual revenue retention rate is an important metric to measure overall client satisfaction and the general quality of our product and service offerings.

## Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA

We disclose Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA because we use them to evaluate our performance, and we believe Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA assist in the comparison of our performance across reporting periods by excluding certain items that we do not believe are indicative of our core operating performance. We believe these metrics are used in the financial community, and we present it to enhance investors' understanding of our operating performance and cash flows.

Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA are not measurements of financial performance under generally accepted accounting principles in the United States, or GAAP, and you should not consider Adjusted Gross Profit as an alternative to gross profit, Adjusted Recurring Gross Profit as an alternative to total recurring revenues, or Adjusted EBITDA as an alternative to net income (loss) or net cash provided by operating activities, in each case as determined in accordance with GAAP. In addition, our definition of Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA may be different than the definition utilized for similarly-titled measures used by other companies.

We define Adjusted Gross Profit as gross profit before amortization of capitalized internal-use software costs and stock-based compensation expense and employer payroll taxes related to stock releases and option exercises. We define Adjusted Recurring Gross Profit as total recurring revenues after cost of recurring revenues and before amortization of capitalized internal-use software costs and stock-based compensation expense and employer payroll taxes related to stock releases and option exercises. We define Adjusted EBITDA as net income (loss) before interest expense, income tax expense (benefit), depreciation and amortization expense, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises, acquisition-related costs and lease exit costs. The table below sets forth our Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA for the periods presented.

	Year Ended June 30,		
	2016	2017	2018
	(in thousands)		
Adjusted Gross Profit	\$ 141,029	\$ 189,272	\$ 247,193
Adjusted Recurring Gross Profit	\$ 161,184	\$ 214,825	\$ 276,857
Adjusted EBITDA	\$ 28,398	\$ 56,190	\$ 81,297

For a further discussion of Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA, including a reconciliation of Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA to GAAP, see Part II, Item 6: "Consolidated Selected Financial Data."

## Basis of Presentation

### Revenues

#### Recurring Fees

We derive the majority of our revenues from recurring fees attributable to our cloud-based payroll and HCM software solutions. Recurring fees for each client generally include a base fee in addition to a fee based on the number of client employees and the number of products a client uses. We also charge fees attributable to our preparation of W-2 documents and annual required filings on behalf of our clients. Over the past three years, our client size has been on average over 100 employees. We derive revenue from a client based on the solutions purchased by the client, the number of client employees as well as the amount, type and timing of services provided with respect to those client employees. As such, the number of client employees on our system is not a good indicator of our financial results in any period. Recurring fees attributable to our cloud-based payroll and HCM solutions accounted for approximately 94%, 95% and 94% of our total revenues during the years ended June 30, 2016, 2017 and 2018, respectively.



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While the majority of our agreements with clients are generally cancellable by the client on 60 days' notice or less, we began entering into term arrangements in fiscal 2018, which are generally over two years in length. Our agreements do not include general rights of return and do not provide clients with the right to take possession of the software supporting the services being provided. We recognize recurring fees in the period in which services are provided and when collection of fees is reasonably assured and the amount of fees is fixed or determinable.

### Interest Income on Funds Held for Clients

We earn interest income on funds held for clients. We collect funds for employee payroll payments and related taxes in advance of remittance to employees and taxing authorities. Prior to remittance to employees and taxing authorities, we earn interest on these funds through demand deposit accounts with financial institutions with which we have automated clearing house, or ACH, arrangements. We also earn interest by investing a portion of funds held for clients in highly liquid, investment-grade marketable securities.

### Implementation Services and Other

Implementation services and other revenues primarily consist of implementation fees charged to new clients for professional services provided to implement and configure our payroll and HCM solutions. Implementations of our payroll solutions typically require only three to four weeks at which point the new client's payroll is first run using our solution, our implementation services are deemed completed, and we recognize the related revenue. We implement additional HCM products as requested by clients and leverage the data within our payroll solution to accelerate our implementation processes. Implementation services and other revenues may fluctuate significantly from quarter to quarter based on the number of new clients, pricing and the product utilization.

### Cost of Revenues

#### Cost of Recurring Revenues

Cost of recurring revenues is generally expensed as incurred and includes costs to provide our payroll and other HCM solutions primarily consisting of employee-related expenses, including wages, stock-based compensation, bonuses and benefits, relating to the provision of ongoing client support, payroll tax filing and distribution of printed checks and other materials. These costs also include amortization of capitalized internal-use software costs, delivery costs and computing costs, as well as bank fees associated with client fund transfers. We expect to realize cost efficiencies over

the long term as our business scales, resulting in improved operating leverage and increased margins.

We capitalize a portion of our internal-use software costs, which are then all amortized as a cost of recurring revenues. We amortized \$5.4 million, \$9.4 million and \$14.3 million of capitalized internal-use software costs in fiscal 2016, 2017 and 2018, respectively.

#### Cost of Implementation Services and Other

Cost of implementation services and other consists primarily of employee-related expenses, including wages, stock-based compensation, bonuses and benefits involved in the implementation of our payroll and other HCM solutions for new clients. Implementation costs are generally fixed in the short-term and exceed associated implementation revenue charged to each client. We intend to grow our business through acquisition of new clients, and doing so will require increased personnel to implement our solutions. Therefore, our cost of implementation services and other is expected to increase in absolute dollars for the foreseeable future.

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## Operating Expenses

## Sales and Marketing

Sales and marketing expenses consist primarily of employee-related expenses for our direct sales and marketing staff, including wages, commissions, stock-based compensation, bonuses and benefits, marketing expenses and other related costs. Commissions are primarily earned and recognized in the month when implementation is complete and the client first utilizes a service and are typically paid within two months after the start of service. Bonuses paid to sales staff for attainment of certain performance criteria are accrued in the fiscal year in which they are earned and are subsequently paid annually in the first fiscal quarter of the following year.

We will seek to grow our number of clients for the foreseeable future and therefore our sales and marketing expense is expected to continue to increase in absolute dollars as we grow our sales organization and expand our marketing activities.

## Research and Development

Research and development expenses consist primarily of employee-related expenses for our research and development and product management staff, including wages, stock-based compensation, bonuses and benefits. Additional expenses include costs related to the development, maintenance, quality assurance and testing of new technologies and ongoing refinement of our existing solutions. Research and development expenses, other than internal-use software costs qualifying for capitalization, are expensed as incurred.

We capitalize a portion of our development costs related to internal-use software. The timing of our capitalized development projects may affect the amount of development costs expensed in any given period. The table below sets forth the amounts of capitalized and expensed research and development expenses for each of fiscal 2016, 2017 and 2018.

	Year Ended June 30,		
	2016	2017	2018
	(in thousands)		
Capitalized portion of research and development	\$ 9,516	\$ 15,414	\$ 18,015
Expensed portion of research and development	26,736	29,098	37,645
Total research and development	\$ 36,252	\$ 44,512	\$ 55,660

We expect to grow our research and development efforts as we continue to broaden our product offerings and extend our technological leadership by investing in the development of new technologies and introducing them to new and existing clients. We expect research and development expenses to continue to increase in absolute dollars but to vary as a percentage of total revenue on a period-to-period basis.

#### General and Administrative

General and administrative expenses consist primarily of employee-related costs, including wages, stock-based compensation, bonuses and benefits for our administrative, finance, accounting, and human resources departments. Additional expenses include consulting and professional fees, occupancy costs, insurance and other corporate expenses. We expect our general and administrative expenses to continue to increase in absolute dollars as our company continues to grow.

#### Other Income (Expense)

Other income (expense) generally consists of interest income related to interest received on our cash and cash equivalents, net of losses on disposals of property and equipment.

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## Results of Operations

The following table sets forth our statements of operations data for each of the periods indicated.

	Year Ended June 30,		
	2016	2017	2018
	(in thousands)		
Consolidated Statements of Operations Data:			
Revenues:			
Recurring fees	\$ 217,416	\$ 284,817	\$ 354,432
Interest income on funds held for clients	2,688	3,631	9,093
Total recurring revenues	220,104	288,448	363,525
Implementation services and other	10,597	11,562	14,002
Total revenues	230,701	300,010	377,527
Cost of revenues:			
Recurring revenues	66,131	85,399	104,009
Implementation services and other	31,954	38,588	45,188
Total cost of revenues	98,085	123,987	149,197
Gross profit	132,616	176,023	228,330
Operating expenses:			
Sales and marketing	61,832	77,506	95,484
Research and development	26,736	29,098	37,645
General and administrative	47,598	62,123	79,252
Total operating expenses	136,166	168,727	212,381
Operating income (loss)	(3,550)	7,296	15,949
Other income (expense)	(124)	73	802
Income (loss) before income taxes	(3,674)	7,369	16,751
Income tax expense (benefit)	177	651	(21,847)
Net income (loss)	\$ (3,851)	\$ 6,718	\$ 38,598

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The following table sets forth our statements of operations data as a percentage of total revenue for each of the periods indicated.

	Year Ended June 30,					
	2016		2017		2018	
<b>Consolidated Statements of Operations Data:</b>						
<b>Revenues:</b>						
Recurring fees	94	%	95	%	94	%
Interest income on funds held for clients	1	%	1	%	2	%
Total recurring revenues	95	%	96	%	96	%
Implementation services and other	5	%	4	%	4	%
Total revenues	100	%	100	%	100	%
<b>Cost of revenues:</b>						
Recurring revenues	29	%	28	%	28	%
Implementation services and other	14	%	13	%	12	%
Total cost of revenues	43	%	41	%	40	%
Gross profit	57	%	59	%	60	%
<b>Operating expenses:</b>						
Sales and marketing	27	%	26	%	25	%
Research and development	11	%	10	%	10	%
General and administrative	21	%	21	%	21	%
Total operating expenses	59	%	57	%	56	%
Operating income (loss)	(2)	%	2	%	4	%
Other income (expense)	0	%	0	%	0	%
Income (loss) before income taxes	(2)	%	2	%	4	%
Income tax expense (benefit)	0	%	0	%	(6)	%
Net income (loss)	(2)	%	2	%	10	%

Comparison of Fiscal Years Ended June 30, 2016, 2017 and 2018

Revenues

(\$ in thousands)

	Year Ended June 30,						Change from		Change from					
	2016		2017		2018		2016 to 2017		2017 to 2018					
Recurring fees	\$	217,416	\$	284,817	\$	354,432	\$	67,401	31	%	\$	69,615	24	%
		94	%	95	%	94	%							

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Percentage of total revenues							
Interest income on funds held for clients	\$ 2,688		\$ 3,631		\$ 9,093		\$ 943
						35 %	\$ 5,462
Percentage of total revenues	1	%	1	%	2	%	
Implementation services and other	\$ 10,597		\$ 11,562		\$ 14,002		\$ 965
						9 %	\$ 2,440
Percentage of total revenues	5	%	4	%	4	%	21 %

Recurring Fees

Recurring fees for the year ended June 30, 2018 increased by \$69.6 million, or 24%, to \$354.4 million from \$284.8 million for the year ended June 30, 2017. Recurring fees increased primarily as a result of incremental revenues from new and existing clients. Excluding clients acquired as part of the BeneFLEX acquisition, the number of clients using our payroll and HCM software solutions at June 30, 2018 increased by 15% to approximately 16,700 from approximately 14,550 at June 30, 2017.

Recurring fees for the year ended June 30, 2017 increased by \$67.4 million, or 31%, to \$284.8 million from \$217.4 million for the year ended June 30, 2016. Recurring fees increased primarily as a result of incremental revenues from new and existing clients, including revenue related to our ACA compliance solution offered to new and existing

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clients, which we launched in fiscal 2016 and experienced significant penetration beginning in the second quarter of fiscal 2016. Our client count at June 30, 2017 increased by 16% to approximately 14,550 from approximately 12,500 at June 30, 2016.

Interest Income on Funds Held for Clients

Interest income on funds held for clients for the year ended June 30, 2018 increased by \$5.5 million, or 150%, to \$9.1 million from \$3.6 million for the year ended June 30, 2017. Interest income on funds held for clients increased primarily as a result of higher average interest rates, increased average daily balances for funds held due to the addition of new clients to our client base and interest income from investing a portion of our funds held for clients in marketable securities starting in July 2017.

Interest income on funds held for clients for the year ended June 30, 2017 increased by \$0.9 million, or 35%, to \$3.6 million from \$2.7 million for the year ended June 30, 2016. Interest income increased primarily as a result of an increased average daily balance of funds held due to the addition of new clients to our client base.

Implementation Services and Other

Implementation services and other revenue for the year ended June 30, 2018 increased by \$2.4 million, or 21%, to \$14.0 million from \$11.6 million for the year ended June 30, 2017 primarily due to the changes in the number of new clients and product mix year over year.

Implementation services and other revenue for the year ended June 30, 2017 increased by \$1.0 million, or 9%, to \$11.6 million from \$10.6 million for the year ended June 30, 2016. Implementation services and other revenue increased primarily as a result of changes in the number of new clients and product mix during fiscal 2017 as compared to fiscal 2016.

Cost of Revenues

(\$ in thousands)

Change from

Change from



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	Year Ended June 30,		2018	2016 to 2017		2017 to 2018	
	2016	2017		\$	%	\$	%
Cost of recurring revenues	\$ 66,131	\$ 85,399	\$ 104,009	\$ 19,268	29 %	\$ 18,610	22 %
Percentage of recurring revenues	30 %	30 %	29 %				
Recurring gross margin	70 %	70 %	71 %				
Cost of implementation services and other	\$ 31,954	\$ 38,588	\$ 45,188	\$ 6,634	21 %	\$ 6,600	17 %
Percentage of implementation services and other	302 %	334 %	323 %				
Implementation gross margin	(202) %	(234) %	(223) %				

Cost of Recurring Revenues

Cost of recurring revenues for the year ended June 30, 2018 increased by \$18.6 million, or 22%, to \$104.0 million from \$85.4 million for the year ended June 30, 2017. Cost of recurring revenues increased primarily as a result of the continued growth of our business, in particular, \$8.6 million in additional employee-related costs resulting from additional personnel necessary to provide services to new and existing clients, \$4.9 million in increased internal-use software amortization and \$4.4 million in delivery and other processing-related fees. Recurring gross margin was 70% and 71% for fiscal 2017 and fiscal 2018, respectively.

Cost of recurring revenues for the year ended June 30, 2017 increased by \$19.3 million, or 29%, to \$85.4 million from \$66.1 million for the year ended June 30, 2016. Cost of recurring revenues increased primarily as a result of the continued growth of our business, in particular \$8.8 million in additional employee-related costs resulting from additional personnel to provide services to new and existing clients, \$5.9 million in delivery and other processing-

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related fees and \$4.0 million in increased internal-use software amortization. Recurring gross margin was 70% in both fiscal 2016 and 2017.

## Cost of Implementation Services and Other

Cost of implementation services and other for the year ended June 30, 2018 increased by \$6.6 million, or 17%, to \$45.2 million from \$38.6 million for the year ended June 30, 2017. The increase in cost of implementation services and other was primarily the result of \$6.1 million of additional employee-related costs resulting from additional personnel necessary to implement our solutions for new and existing clients during fiscal 2018.

Cost of implementation services and other for the year ended June 30, 2017 increased by \$6.6 million, or 21%, to \$38.6 million from \$32.0 million for the year ended June 30, 2016. Cost of implementation services and other increased by \$5.6 million primarily related to employee-related costs to implement our solutions for new and existing clients.

## Operating Expenses

(\$ in thousands)

## Sales and Marketing

	Year Ended June 30,		2018	Change from 2016 to 2017		Change from 2017 to 2018	
	2016	2017		\$	%	\$	%
Sales and marketing	\$ 61,832	\$ 77,506	\$ 95,484	\$ 15,674	25 %	\$ 17,978	23 %
Percentage of total revenues	27 %	26 %	25 %				

Sales and marketing expenses for the year ended June 30, 2018 increased by \$18.0 million, or 23%, to \$95.5 million from \$77.5 million for the year ended June 30, 2017. The increase in sales and marketing expense was primarily the result of \$15.7 million of additional employee-related costs from the expansion of our sales team (including management, sales engineers, direct sales, sales administration and sales lead generation support) and \$1.0 million in additional stock-based compensation associated with our equity incentive plan.

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Sales and marketing expenses for the year ended June 30, 2017 increased by \$15.7 million, or 25%, to \$77.5 million from \$61.8 million for the year ended June 30, 2016. The increase in sales and marketing expenses in fiscal 2017 was primarily the result of \$12.0 million of additional employee-related costs from the expansion of our sales team (including management, sales engineers, direct sales, sales administration and sales lead generation support). The increase was also attributable to \$1.8 million of stock-based compensation associated with our equity incentive plan.

### Research and Development

	Year Ended June 30,		2018	Change from 2016 to 2017		Change from 2017 to 2018	
	2016	2017		\$	%	\$	%
Research and development	\$ 26,736	\$ 29,098	\$ 37,645	\$ 2,362	9 %	\$ 8,547	29 %
Percentage of total revenues	11 %	10 %	10 %				

Research and development expenses for the year ended June 30, 2018 increased by \$8.5 million, or 29%, to \$37.6 million from \$29.1 million for the year ended June 30, 2017. The increase in research and development expenses was primarily the result of \$9.6 million of additional employee-related costs related to additional development personnel and \$0.9 million of additional stock-based compensation associated with our equity incentive plan, partially offset by higher year-over-year capitalized internal-use software costs of \$2.8 million.

Research and development for the year ended June 30, 2017 increased by \$2.4 million, or 9%, to \$29.1 million from \$26.7 million for the year ended June 30, 2016. Research and development costs increased in fiscal 2017 primarily due to \$7.2 million of additional employee-related expenses and \$1.0 million of additional stock-based compensation

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associated with our equity incentive plan, partially offset by higher year-over-year capitalized internal-use software costs of \$6.1 million.

## General and Administrative

	Year Ended June 30,		2018	Change from 2016 to 2017		Change from 2017 to 2018	
	2016	2017		\$	%	\$	%
General and administrative	\$ 47,598	\$ 62,123	\$ 79,252	\$ 14,525	31 %	\$ 17,129	28 %
Percentage of total revenues	21 %	21 %	21 %				

General and administrative expenses for the year ended June 30, 2018 increased by \$17.1 million, or 28%, to \$79.3 million from \$62.1 million for the year ended June 30, 2017. The increase in general and administrative expense was primarily the result of \$6.6 million of additional employee-related costs related to additional personnel, \$4.8 million of increased occupancy costs incurred as a result of our requirement for additional office space, \$2.3 million of costs incurred as a result of our early lease exit as explained in Note 10 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” and \$4.2 million in additional stock-based compensation associated with our equity incentive plan, partially offset by the prior year impact related to modified equity awards of \$2.9 million as explained in Note 13 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data”.

General and administrative expenses for the year ended June 30, 2017 increased by \$14.5 million, or 31%, to \$62.1 million from \$47.6 million for the year ended June 30, 2016. General and administrative expenses increased primarily as a result of \$6.3 million of additional stock-based compensation costs, of which \$2.9 million is related to modified equity awards as explained in Note 13 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data”, \$3.9 million of increased occupancy costs incurred as a result of our requirement for additional office space and \$3.8 million of additional employee-related costs related to additional personnel.

## Other Income (Expense)

Year Ended June 30,			Change from 2016 to 2017		Change from 2017 to 2018	
2016	2017	2018	\$	%	\$	%

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Other income (expense)	\$ (124)		\$ 73		\$ 802		\$ 197	*	\$ 729	999	%
Percentage of total revenues	0	%	0	%	0	%					

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\*Not Meaningful

Other income (expense) for the year ended June 30, 2018 increased by \$0.7 million as compared to the year ended June 30, 2017. The increase in other income (expense) was primarily due to higher average interest rates as well as higher average daily balances for our cash and cash equivalents.

Other income (expense) for the year ended June 30, 2017 increased by \$0.2 million as compared to the year ended June 30, 2016. Other income (expense) for the year ended June 30, 2017 primarily consists of interest income earned on our cash and cash equivalents, partially offset by loss on the disposal of property and equipment.

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## Income Tax Expense (Benefit)

	Year Ended June 30,			Change from		Change from	
	2016	2017	2018	2016 to 2017		2017 to 2018	
				\$	%	\$	%
Effective tax rate	*	*	*				
Income tax expense (benefit)	\$ 177	\$ 651	\$ (21,847)	\$ 474	268 %	\$ (22,498)	*
Percentage of total revenues	0 %	0 %	(6) %				

\*Not Meaningful

The difference in income tax expense (benefit) of \$22.5 million for the year ended June 30, 2018 as compared to the year ended June 30, 2017 was primarily due to a \$22.8 million tax benefit from the release of the valuation allowance and a \$10.5 million benefit from excess benefits realized from employee stock exercises, partially offset by \$8.6 million in tax expense from the Tax Cuts and Jobs Act of 2017 and the annual provision for income taxes of \$4.6 million.

Income tax expense for the year ended June 30, 2017 was higher due to the generation of net income for fiscal 2017 as compared to the net loss for the year ended June 30, 2016.

See Note 11 of the Notes to Consolidated Financial Statements included in Part II, Item 8: "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K for further details on the valuation allowance and a reconciliation of the U.S. federal statutory rate to the effective tax rate.

### Critical Accounting Policies and Significant Judgments and Estimates

In preparing our financial statements and accounting for the underlying transactions and balances in accordance with GAAP, we apply various accounting policies that require our management to make estimates, judgments and assumptions that affect the amounts reported in our financial statements. We consider the policies discussed below critical to understanding our financial statements, as their application places the most significant demands on management's judgment. Management bases its estimates, judgments and assumptions on historical experience, current economic and industry conditions and on various other factors deemed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Because the use of estimates is an integral part of the financial reporting process,

actual results could differ and such differences could be material.

## Revenue Recognition

We recognize revenue in accordance with ASC 605-25, Revenue Recognition—Multiple Element Arrangements, Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (“ASU 2009 13”), and Staff Accounting Bulletin 104, Revenue Recognition. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

We derive revenue predominantly from recurring fees and non-recurring service fees. Recurring fees are collected under agreements for payroll, timekeeping, HR-related cloud-based computing services and monthly time clock rentals. While the majority of our agreements are generally cancellable by the client on 60 days’ notice or less, in fiscal 2018, we began entering into some term arrangements, which are generally two years in length. Non-recurring service fees consist mainly of implementation and custom reporting services. Such fees are billed to clients and revenue is recorded upon completion of the service. Our agreements do not include general rights of return and do not provide clients with the right to take possession of the software supporting the services being provided. As such, the agreements are accounted for as service contracts.

For each agreement, we evaluate whether the individual deliverables qualify as separate units of accounting. If one or more of the deliverables does not have standalone value upon delivery, the deliverables that do not have

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standalone value are generally combined and treated as a single unit of accounting by frequency of occurrence for the product category involved such as biweekly payroll or monthly timekeeping services. Revenues for arrangements treated as a single unit of accounting are generally recognized within the same month that the services are rendered.

In determining whether implementation services can be accounted for separately from recurring revenues, we consider the nature of the implementation services and the availability of the implementation services from other vendors. We were able to establish standalone value for implementation activities based on the historical activity of third-party vendors that performed these services and as such, we account for such implementation services separately from the recurring revenues.

If the recurring services have standalone value upon delivery, we account for each separately and revenues are recognized as services are delivered with allocation of consideration based on the relative selling price method as established in ASU 2009-13. That method requires the selling price of each element in a multiple-deliverable arrangement to be based on, in descending order: (i) vendor specific objective evidence of fair value (“VSOE”), (ii) third-party evidence of fair value (“TPE”) or (iii) management’s best estimate of the selling price (“BESP”).

We are not able to establish VSOE because the deliverables are sold across an insufficiently narrow range of prices on a stand-alone basis and are also not able to establish TPE because no third-party offerings are reasonably comparable to our offerings. We thus established our BESP by service offering, requiring the use of significant estimates and judgment. We consider numerous factors, including the nature of the deliverables themselves and the pricing and discounting practices utilized by our sales force. Arrangement consideration is allocated to each deliverable based on the established BESP and subject to the limitation that because the arrangements are cancellable with 60 days’ or less notice or additional consideration is contingent on the delivery of future services, recurring revenue is not allocated to any deliverable until the consideration has been earned, typically with each payroll cycle or monthly, depending on the service.

## Capitalized Internal-Use Software Costs

We apply ASC 350-40, Intangibles—Goodwill and Other—Internal-Use Software, to the accounting for costs of internal-use software. Software development costs are capitalized when application development begins, it is probable that the project will be completed, and the software will be used as intended. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. We also capitalize certain costs related to specific upgrades and enhancements when it is probable the expenditures will result in significant additional functionality. The capitalization policy provides for the capitalization of certain payroll costs for employees who are directly associated with developing internal-use software as well as certain external direct costs. Capitalized employee costs are limited to the time directly spent on such projects.



Internal-use software is amortized on a straight-line basis, generally over a 24 or 36-month period. We evaluate the useful lives of these assets on an annual basis and test for impairments whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to capitalized internal-use software during the years ended June 30, 2016, 2017 or 2018. We capitalized \$9.5 million, \$15.4 million, and \$18.0 million of internal-use software costs for the years ended June 30, 2016, 2017 and 2018, respectively, including stock-based compensation costs of \$1.1 million, \$1.8 million and \$2.0 million in the years ended June 30, 2016, 2017 and 2018, respectively. We amortized \$5.4 million, \$9.4 million, and \$14.3 million of capitalized internal-use software costs for the years ended June 30, 2016, 2017 and 2018, respectively. In fiscal 2016, fiscal 2017 and fiscal 2018, we developed significant additional functionality in several of our applications. This development resulted in an increase in capitalized internal-use software costs in fiscal 2018 as compared to fiscal 2017 and in fiscal 2017 as compared to fiscal 2016.

#### Goodwill and Intangible Assets

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is not amortized, but instead is tested for impairment at the reporting unit level. If the fair value of the reporting unit is less than its carrying amount, we would record an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value.

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We perform our annual impairment review of goodwill in our fiscal fourth quarter or when a triggering event occurs between annual impairment tests. No impairment was recorded in fiscal 2016, 2017 or 2018 as a result of our qualitative assessments over our single reporting segment.

Intangible assets are comprised primarily of client relationship acquisitions and are reported net of accumulated amortization on the consolidated balance sheets. Client relationships use the straight-line method of amortization over a seven to nine-year time frame, while the non-solicitation agreements uses the straight-line method of amortization over two to four year life of the agreements. Amortization expense associated with our intangible assets was \$1.5 million during the years ended June 30, 2016 and 2017 and \$1.7 million during the year ended June 30, 2018. We test intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. There were no such events or changes in circumstances during the years ended June 30, 2016, 2017 or 2018.

## Income Taxes

We account for federal income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We recognized \$8.6 million in tax expense for the year ended June 30, 2018 resulting from the Tax Cuts and Jobs Act.

Deferred tax assets may be reduced by a valuation allowance to the extent we determine it is more likely than not that some portion or all of the deferred tax assets will not be realized. The valuation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns and future profitability. Our accounting for deferred tax consequences represents the best estimate of those future events. Changes in current estimates, due to unanticipated events or otherwise, could have an adverse impact on our financial condition and results of operations.

In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. As such, it is generally difficult for positive evidence regarding projected future taxable income exclusive of reversing taxable temporary differences to outweigh objective negative evidence of recent financial reporting losses. Cumulative losses in recent years are significant negative evidence that is difficult to overcome in determining that a valuation allowance is not needed against deferred tax assets. We released a substantial portion of our valuation allowance during the year ended June 30, 2018.

We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

#### Stock-Based Compensation

We maintain a 2008 Equity Incentive Plan (the “2008 Plan”) and a 2014 Equity Incentive Plan (the “2014 Plan”) pursuant to which we have issued options to purchase shares of our common stock and grants of restricted stock awards to employees, officers, directors and consultants. The 2014 Plan serves as the successor to the 2008 Plan and permits the granting of options to purchase common stock and other equity incentives at the discretion of the compensation committee of our board of directors. We will not grant any additional awards under our 2008 Plan, though our 2008 Plan will continue to govern the terms and conditions of all outstanding equity awards granted under the 2008 Plan.

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As of June 30, 2018, options to purchase 1.9 million shares of our common stock were outstanding, 1.9 million restricted stock units were outstanding and 10.0 million shares of our common stock were reserved for future grant.

The following table presents data related to stock options granted on the date indicated:

	Aug. 17, 2015
Options granted (in thousands)	149
Fair value of stock	\$ 35.28
Exercise price	\$ 35.28
Fair value of option	\$ 12.92

There were no options granted during fiscal 2017 or fiscal 2018. Equity-classified awards are measured at the grant date fair value of the award and expense is recognized, net of assumed forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. We estimate the grant date fair value of stock options using the Black-Scholes Option-Pricing Model, or Black-Scholes, which requires the use of certain subjective assumptions. Below is a table of the key weighted-average assumptions used in the option valuation calculation for options issued on the date indicated.

	Aug. 17, 2015	
Valuation assumptions:		
Weighted average expected dividend yield	—	
Weighted average expected volatility	34.0	%
Weighted average expected term (years)	6.25	
Weighted average risk-free interest rate	1.83	%

We use a dividend yield assumption of zero, as we have never paid regular cash dividends on our common stock since our IPO and presently have no intention of paying any such cash dividends. Since our shares were not publicly traded prior to March 2014, expected volatility is estimated based on the average historical volatility of similar entities with publicly traded shares. The expected life represents the period of time the stock options are expected to be outstanding and is based on the simplified method. Under the simplified method, the expected life of an option is presumed to be the mid-point between the vesting date and the end of the contractual term. Given our limited history of trading as a public company, the Company utilizes the simplified method due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to otherwise estimate the expected life of the stock options. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve at the date of grant.

Stock-based compensation expense was \$17.6 million, \$26.7 million and \$30.4 million for the years ended June 30, 2016, 2017 and 2018, respectively. If factors change and we employ different assumptions, stock-based compensation expense may differ from what we have recorded in the past. If there is a difference between the assumptions used in determining stock-based compensation expense and the actual factors, which become known over time, we may change the input factors used in determining stock-based compensation costs for future grants. These changes, if any, may adversely impact our results of operations in the period such changes are made. We expect to continue to grant equity awards in the future, and to the extent that we do, our actual stock-based compensation expense recognized in future periods will likely increase.

Based on the closing stock price on June 29, 2018 of \$58.86, the aggregate intrinsic value of outstanding options to purchase shares of our common stock as of June 30, 2018 was \$88.6 million, of which \$84.9 million related to vested options and \$3.7 million to unvested options. The aggregate intrinsic value of outstanding restricted stock units as of June 30, 2018 was \$110.6 million, of which all were unvested.

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### Follow-On Offering

In December 2014, the Company completed a follow-on offering in which it issued and sold 0.8 million shares of common stock and existing shareholders sold 3.9 million shares of common stock at a public offering price of \$26.25 per share. The Company did not receive any proceeds from the sale of common stock by the existing shareholders. The Company received net proceeds of \$18.4 million after deducting underwriting discounts and commissions of \$0.9 million and other offering expenses of \$0.4 million.

In January 2015, the underwriters for the Company's follow-on offering exercised their option to purchase 0.4 million additional shares from certain shareholders of the Company of the 0.7 million available as described in the final prospectus filed with the Securities and Exchange Commission ("SEC") in December 2014. The Company did not receive any proceeds from the sale of common stock by the existing shareholders.

### Secondary Offering

In September 2015, the Company completed a secondary offering in which its existing shareholders sold 3.7 million shares of common stock at a public offering price of \$29.75 per share. The Company did not receive any proceeds from the sale of common stock by the existing shareholders.

In October 2015, the underwriters for the Company's secondary offering exercised their option to purchase 0.6 million additional shares from certain shareholders of the Company as described in the final prospectus filed with the SEC on September 25, 2015. The Company did not receive any proceeds from the sale of common stock by the existing shareholders.

### Liquidity and Capital Resources

Our primary liquidity needs are related to the funding of general business requirements, including working capital requirements, research and development, and capital expenditures. As of June 30, 2018, our principal source of liquidity was \$137.2 million of cash and cash equivalents.

In order to grow our business, we intend to increase our personnel and related expenses and to make significant investments in our platform, data centers and general infrastructure. The timing and amount of these investments will vary based on the rate at which we can add new clients and new personnel and the scale of our application

development, data centers and other activities. Many of these investments will occur in advance of our experiencing any direct benefit from them, which could negatively impact our liquidity and cash flows during any particular period and may make it difficult to determine if we are effectively allocating our resources. However, we expect to fund our operations, capital expenditures and other investments principally with cash flows from operations, and to the extent that our liquidity needs exceed our cash from operations, we would look to our cash on hand and seek to establish borrowing capacity to satisfy those needs.

Our cash flows from investing and financing activities are influenced by the amount of funds held for clients, which varies significantly from quarter to quarter. The balance of the funds we hold depends on our clients' payroll calendar, and therefore, such balance changes from period to period in accordance with the timing of each payroll cycle. Funds held for clients are primarily placed in demand deposit accounts with various financial institutions. We also invest a portion of the funds held for clients in highly liquid, investment-grade marketable securities. Funds held for clients are used for the repayment of client fund obligations.

We believe our current cash and cash equivalents and cash flow from operations will be sufficient to meet our working capital, capital expenditure and other investment requirements for at least the next 12 months.

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## Cash Flows

The following table sets forth data regarding cash flows for the periods indicated:

	Year Ended June 30,		
	2016	2017	2018
Net cash provided by operating activities	\$ 32,993	\$ 61,980	\$ 97,866
Cash flows from investing activities:			
Purchases of available-for-sale securities from funds held for clients	—	—	(196,594)
Proceeds from sales and maturities of available-for-sale securities from funds held for clients	—	—	73,044
Net change in funds held for clients' cash and cash equivalents	(648,403)	297,163	(158,394)
Capitalized internal-use software costs	(8,391)	(13,641)	(15,638)
Purchases of property and equipment	(16,083)	(21,338)	(21,676)
Lease allowances used for tenant improvements	—	(2,845)	(11,754)
Acquisition of business, net of cash acquired	(483)	—	(8,346)
Net cash provided by (used in) investing activities	(673,360)	259,339	(339,358)
Cash flows from financing activities:			
Net change in client fund obligations	648,403	(297,163)	281,467
Proceeds from exercise of stock options	137	34	—
Proceeds from employee stock purchase plan	2,991	3,677	4,304
Taxes paid related to net share settlement of equity awards	(5,926)	(11,342)	(10,554)
Excess tax benefits from stock-based compensation	—	447	—
Net cash provided by (used in) financing activities	645,605	(304,347)	275,217
Net change in cash and cash equivalents	\$ 5,238	\$ 16,972	\$ 33,725

## Operating Activities

Net cash provided by operating activities was \$33.0 million, \$62.0 million and \$97.9 million for the years ended June 30, 2016, 2017 and 2018, respectively.

The increase in net cash provided by operating activities from fiscal 2017 to fiscal 2018 was primarily due to improved operating results after adjusting for non-cash items, including stock-based compensation expense and depreciation and amortization expense partially offset by the change in deferred income tax related to non-cash tax adjustments. Refer to Note 11 of the Notes to Consolidated Financial Statements included in Part II, Item 8: "Financial Statements and Supplementary Data" for additional detail related to the change in deferred income tax. The increase was also due to an additional \$8.9 million received for tenant improvement allowances. The increase in net cash provided by operating activities from fiscal 2016 to fiscal 2017 was primarily due to improved operating results after



adjusting for non-cash items, including stock-based compensation expense and depreciation and amortization expense.

### Investing Activities

Net cash provided by (used in) investing activities was \$(673.4) million, \$259.3 million and \$(339.4) million, for the years ended June 30, 2016, 2017 and 2018, respectively.

Changes in net cash provided by (used in) investing activities are significantly influenced by the amount of funds held for clients at the end of a reporting period. Changes in the amount of funds held for clients from period to period will vary substantially as a result of the timing of payroll and tax obligations due. Our payroll processing activities involve the movement of significant funds from accounts of employers to employees and relevant taxing authorities. During the year ended June 30, 2018, we processed over \$110 billion in payroll transactions. Though we debit a client's account prior to any disbursement on its behalf, there is a delay between our payment of amounts due to employees and taxing and other regulatory authorities and when the incoming funds from the client to cover these amounts payable actually clear into our operating accounts. We currently have agreements with eleven banks to execute ACH and wire transfers to support our client payroll and tax services. We believe we have sufficient capacity under

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these ACH arrangements to handle our transactions for the foreseeable future. Fluctuations in the net change in funds held for clients' cash and cash equivalents are also impacted by the timing of purchases and sales and maturities of investments as we invest a portion of the funds held for clients in highly liquid, investment-grade marketable securities.

Excluding the net change in funds held for clients' cash and cash equivalents and purchases and proceeds from sales and maturities of available-for-sale securities from funds held for clients, our net cash used in investing activities was \$25.0 million, \$37.8 million and \$57.4 million, for the years ended June 30, 2016, 2017 and 2018, respectively. The change in net cash used in investing activities from fiscal 2017 to fiscal 2018, excluding funds held for clients related activities, was primarily due to an additional \$8.9 million in lease allowances used for tenant improvements and \$8.3 million in net cash used to acquire BeneFLEX during fiscal 2018. The change in net cash used in investing activities from fiscal 2016 to fiscal 2017, excluding funds held for clients, was primarily due to increased capitalized internal-use software costs of \$5.3 million, increased purchases of property and equipment of \$5.3 million and \$2.8 million in lease allowances used for tenant improvements.

## Financing Activities

Net cash provided by (used in) financing activities was \$645.6 million, \$(304.3) million and \$275.2 million for the years ended June 30, 2016, 2017 and 2018, respectively. Excluding the net change in client fund obligations, net cash used in financing activities was \$(2.8) million, \$(7.2) million and \$(6.3) million for the years ended June 30, 2016, 2017 and 2018, respectively. The change in net cash used in financing activities from fiscal 2017 to fiscal 2018, excluding the net change in client fund obligations, was primarily the result of a \$0.8 million decrease in taxes paid related to net share settlement of equity awards. The change in net cash used in financing activities from fiscal 2016 to fiscal 2017, excluding the net change in client fund obligations, was primarily the result of a \$5.4 million increase in taxes paid related to net share settlement of equity awards.

## Contractual Obligations and Commitments

Our principal commitments consist of operating lease obligations. The following table summarizes our contractual obligations at June 30, 2018:

	Payment Due By Fiscal Period				2024 and Thereafter
	Total	2019	2020-2021	2022-2023	
Operating lease obligations	\$ 112,485	\$ 8,909	\$ 19,203	\$ 17,148	\$ 67,225
Unconditional purchase obligations	6,024	3,951	2,073	—	—

\$ 118,509	\$ 12,860	\$ 21,276	\$ 17,148	\$ 67,225
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### Capital Expenditures

We expect to continue to invest in capital spending as we continue to grow our business and expand and enhance our operating facilities, data centers and technical infrastructure. Future capital requirements will depend on many factors, including our rate of sales growth. In the event that our sales growth or other factors do not meet our expectations, we may eliminate or curtail capital projects in order to mitigate the impact on our use of cash. Capital expenditures were \$16.1 million, \$21.3 million and \$21.7 million for the years ended June 30, 2016, 2017 and 2018, respectively, exclusive of capitalized internal-use software costs of \$8.4 million, \$13.6 million, and \$15.6 million for the same periods, respectively. We also spent \$2.8 million and \$11.8 million in fiscal 2017 and fiscal 2018, respectively, on capital expenditures for which we received reimbursement for tenant improvement allowances.

### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that may be material to investors.

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New Accounting Pronouncements

Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for a discussion of recently issued accounting standards.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

We have operations solely in the United States and are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate and certain other exposures as well as risks relating to changes in the general economic conditions in the United States. We have not used, nor do we intend to use, derivatives to mitigate the impact of interest rate or other exposure or for trading or speculative purposes.

Interest Rate Risk

As of June 30, 2018, we had cash and cash equivalents of \$137.2 million and funds held for clients of \$1,225.6 million. We deposit our cash and cash equivalents and significant portions of our funds held for clients in demand deposit accounts with various financial institutions. Starting in July 2017, we invested a portion of our funds held for clients in marketable securities including commercial paper, corporate bonds, asset-backed securities and U.S. treasury securities which were classified as available-for-sale securities as of June 30, 2018. Our investment policy is focused on generating higher yields from these investments while preserving liquidity and capital. However, as a result of our investing activities, we are exposed to changes in interest rates that may materially affect our financial statements.

In a falling rate environment, a decline in interest rates would decrease our interest income earned on both cash and cash equivalents and funds held for clients. An increase in the overall interest rate environment may cause the market value of portions of our funds held for clients invested in fixed rate available-for-sale securities to decline. If we are forced to sell some or all of these securities at lower market values, we may incur investment losses. However, because we classify all marketable securities as available-for-sale, no gains or losses are recognized due to changes in interest rates until such securities are sold or decreases in fair value are deemed to be other-than-temporary. We have not recorded any other-than-temporary impairment losses to date.

Based upon a sensitivity model that measures market value changes caused by interest rate fluctuations, an immediate 25-basis point increase in interest rates would have resulted in a decrease in the market value of our available-for-sale securities included in funds held for clients by \$0.2 million as of June 30, 2018. A 25-basis point decrease in interest rates would have resulted in a \$0.2 million increase in the market value of our available-for-sale securities included in

funds held for clients as of June 30, 2018. Fluctuations in the value of our available-for-sale securities caused by changes in interest rates are recorded in other comprehensive income and are only realized if we sell the underlying securities.

#### Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. Nonetheless, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

#### Item 8. Financial Statements and Supplementary Data.

The information required by this item is incorporated by reference to the consolidated financial statements and accompanying notes set forth on pages F-1 through F-27 of this Annual Report on Form 10-K.

#### Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

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Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2018, the end of the period covered by this Annual Report on Form 10-K. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

Management’s Report on Internal Control Over Financial Reporting and Attestation Report of the Registered Public Accounting Firm

Our management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2018, based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013 framework). Based on this evaluation under the Internal Control—Integrated Framework our Chief Executive Officer and Chief Financial Officer have concluded

that our internal control over financial reporting was effective as of June 30, 2018.

Our independent registered public accounting firm, which has audited our financial statements, has also audited the effectiveness of our internal control over financial reporting as of June 30, 2018, as stated in their report, which is included in Item 15(a)(1) of this Annual Report on Form 10-K.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Limitations on Controls

Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and

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fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

Item 9B. Other Information.

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by Part III, Item 10, will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

Item 11. Executive Compensation

Information required by Part III, Item 11, will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information required by Part III, Item 12, will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information required by Part III, Item 13, will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Information required by Part III, Item 14, will be included in our Proxy Statement relating to our 2019 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2018, and is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents Filed with Report

(1) Financial Statements.

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets as of June 30, 2017 and 2018</u>	F-4
<u>Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended June 30, 2016, 2017 and 2018</u>	F-5
<u>Consolidated Statements of Changes in Stockholders' Equity for the years ended June 30, 2016, 2017 and 2018</u>	F-6
<u>Consolidated Statements of Cash Flows for the years ended June 30, 2016, 2017 and 2018</u>	F-7
<u>Notes to the Consolidated Financial Statements</u>	F-8

(2) Exhibits.

The information required by this Item is set forth on the Exhibit Index immediately following this page.

Item 16. Form 10-K Summary

None.

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## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date
		Form	File No.	Exhibit	
2.1	<u>Share Exchange Agreement, dated November 7, 2013.</u>	S-1	333-193661	2.1	January 30, 2014
3.1	<u>First Amended and Restated Certificate of Incorporation of the Registrant.</u>	S-1/A	333-193661	3.2	February 14, 2014
3.2	<u>Amended and Restated By-Laws of the Registrant.</u>	10-K	001-36348	3.2	August 11, 2017
4.1	<u>Amended and Restated Investor Rights Agreement, dated June 29, 2012.</u>	S-1	333-193661	4.1	January 30, 2014
10.1	<u>Form of Indemnification Agreement for directors and officers.</u>	S-1	333-193661	10.2	January 30, 2014
10.2†	<u>2008 Equity Incentive Plan and forms of agreement thereunder.</u>	S-1	333-193661	10.3	January 30, 2014
10.2.1†	<u>First Amendment to the 2008 Equity Incentive Plan, dated August 5, 2010.</u>	S-1	333-193661	10.3.1	January 30, 2014
10.2.2†	<u>Second Amendment to the 2008 Equity Incentive Plan, dated June 29, 2012.</u>	S-1	333-193661	10.3.2	January 30, 2014
10.3†	<u>2014 Equity Incentive Plan and forms of agreement thereunder.</u>	S-1/A	333-193661	10.4	February 14, 2014
10.4†	<u>Third Amended and Restated Executive Employment Agreement between Paylocity Corporation and Steven R. Beauchamp, dated February 7, 2014.</u>	S-1/A	333-193661	10.5	February 14, 2014
10.5†	<u>Second Amended and Restated Executive Employment Agreement between Paylocity Corporation and Michael R. Haske, dated February 7, 2014.</u>	S-1/A	333-193661	10.7	February 14, 2014
10.6	<u>Office Lease between 3850 Wilke LLC and Paylocity Corporation, dated January 12, 2007.</u>	S-1	333-193661	10.8	January 30, 2014

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10.7.1	<u>Amendment to Office Lease, dated January 5, 2011.</u>	S-1	333-193661	10.8.1	January 30, 2014
10.7.2	<u>Amendment to Office Lease, dated May 6, 2013.</u>	S-1	333-193661	10.8.2	January 30, 2014
10.7.3	<u>Multi-Tenant Office Lease Agreement, dated June 1, 2016, by and between Paylocity Corporation and RPAI Schaumburg American Lane, L.L.C.</u>	8-K	001-36348	10.1	June 2, 2016
10.8†	<u>2014 Employee Stock Purchase Plan.</u>	S-1/A	333-193661	10.9	February 14, 2014
10.10†	<u>Executive Employment Agreement between Paylocity Corporation and Mark S. Kinsey, dated May 1, 2015.</u>	10-K	001-36348	10.11	August 12, 2016

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Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date
		Form	File No.	Exhibit	
10.11†	<u>Executive Employment Agreement between Paylocity Corporation and Edward W. Gaty, dated August 8, 2016.</u>	8-K	001-36348	10.1	August 9, 2016
10.12†	<u>Executive Employment Agreement between Paylocity Corporation and Toby J. Williams, dated September 18, 2017.</u>	10-Q	001-36348	10.1	November 3, 2017
14.1	<u>Code of Business Conduct and Ethics.</u>	10-K	001-36348	14.1	August 22, 2014
21.1*	<u>List of Subsidiaries of the Registrant.</u>				
23.1*	<u>Consent of KPMG LLP, Independent Registered Public Accounting Firm.</u>				
24.1*	<u>Power of Attorney (see page 65 to this Annual Report on Form 10-K).</u>				
31.1*	<u>Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.</u>				
31.2*	<u>Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.</u>				
32.1**	<u>Certification of Chief Executive Officer Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.</u>				
32.2**	<u>Certification of Chief Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.</u>				
101.INS*	XBRL Instance Document.				
101.SCH*	XBRL Taxonomy Extension Schema.				
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.				

101.LAB\* XBRL Taxonomy Extension Label Linkbase.

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase.

101.DEF\* XBRL Taxonomy Extension Definition Linkbase.

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†Management contract, compensatory plan or arrangement.

\*Filed herewith.

\*\*Furnished herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 10, 2018

PAYLOCITY HOLDING CORPORATION

By: /s/ Steven R. Beauchamp  
Steven R. Beauchamp  
Chief Executive Officer (Principal Executive Officer) and Director



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## SIGNATURES AND POWER OF ATTORNEY

Each person whose individual signature appears below hereby authorizes and appoints Steven R. Beauchamp and Toby J. Williams, and each of them, with full power of substitution and resubstitution and full power to act without the other, as his or her true and lawful attorney-in-fact and agent to act in his or her name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their or his substitute or substitutes may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.

Signature	Title	Date
/s/ Steven R. Beauchamp Steven R. Beauchamp	Chief Executive Officer (Principal Executive Officer) and Director	August 10, 2018
/s/ Toby J. Williams Toby J. Williams	Chief Financial Officer (Principal Financial Officer)	August 10, 2018
/s/ Andrew Cappotelli Andrew Cappotelli	Chief Accounting Officer (Principal Accounting Officer)	August 10, 2018
/s/ Steven I. Sarowitz Steven I. Sarowitz	Chairman of the Board of Directors	August 10, 2018
/s/ Ellen Carnahan Ellen Carnahan	Director	August 10, 2018
/s/ Jeffrey T. Diehl Jeffrey T. Diehl	Director	August 10, 2018

/s/ Andres D. Reiner  
Andres D. Reiner

Director

August 10,  
2018

/s/ Ronald V. Waters, III  
Ronald V. Waters, III

Director

August 10,  
2018

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Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors  
Paylocity Holding Corporation:

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting

We have audited the accompanying consolidated balance sheets of Paylocity Holding Corporation and subsidiaries (the Company) as of June 30, 2018 and 2017, the related consolidated statements of operations and comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2018 and the related notes (collectively, the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, "Management's Report on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting

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principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

We have served as the Company's auditor since 2013.

Chicago, Illinois  
August 10, 2018

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## PAYLOCITY HOLDING CORPORATION

## Consolidated Balance Sheets

(in thousands, except per share data)

	As of June 30,	
	2017	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 103,468	\$ 137,193
Accounts receivable, net	2,040	3,453
Prepaid expenses and other	14,879	11,980
Total current assets before funds held for clients	120,387	152,626
Funds held for clients	942,459	1,225,614
Total current assets	1,062,846	1,378,240
Long-term prepaid expenses	1,535	1,504
Capitalized internal-use software, net	17,394	21,094
Property and equipment, net	40,756	62,029
Intangible assets, net	8,907	13,002
Goodwill	6,003	9,590
Deferred income tax assets, net	—	22,140
Total assets	\$ 1,137,441	\$ 1,507,599
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,046	\$ 2,990
Accrued expenses	30,301	42,241
Total current liabilities before client fund obligations	32,347	45,231
Client fund obligations	942,459	1,225,614
Total current liabilities	974,806	1,270,845
Deferred rent	14,621	22,812
Other long-term liabilities	—	1,118
Deferred income tax liabilities, net	401	—
Total liabilities	\$ 989,828	\$ 1,294,775
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000 authorized, no shares issued and outstanding at June 30, 2017 and 2018	\$ —	\$ —
Common stock, \$0.001 par value, 155,000 shares authorized at June 30, 2017 and 2018; 51,738 shares issued and outstanding at June 30, 2017 and 52,758 shares	52	53

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issued and outstanding at June 30, 2018		
Additional paid-in capital	192,837	219,588
Accumulated deficit	(45,276)	(6,678)
Accumulated other comprehensive loss	—	(139)
Total stockholders' equity	\$ 147,613	\$ 212,824
Total liabilities and stockholders' equity	\$ 1,137,441	\$ 1,507,599

See accompanying notes to consolidated financial statements.

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## PAYLOCITY HOLDING CORPORATION

## Consolidated Statements of Operations and Comprehensive Income (Loss)

(in thousands, except per share data)

	For the Years Ended June 30,		
	2016	2017	2018
Revenues:			
Recurring fees	\$ 217,416	\$ 284,817	\$ 354,432
Interest income on funds held for clients	2,688	3,631	9,093
Total recurring revenues	220,104	288,448	363,525
Implementation services and other	10,597	11,562	14,002
Total revenues	230,701	300,010	377,527
Cost of revenues:			
Recurring revenues	66,131	85,399	104,009
Implementation services and other	31,954	38,588	45,188
Total cost of revenues	98,085	123,987	149,197
Gross profit	132,616	176,023	228,330
Operating expenses:			
Sales and marketing	61,832	77,506	95,484
Research and development	26,736	29,098	37,645
General and administrative	47,598	62,123	79,252
Total operating expenses	136,166	168,727	212,381
Operating income (loss)	(3,550)	7,296	15,949
Other income (expense)	(124)	73	802
Income (loss) before income taxes	(3,674)	7,369	16,751
Income tax expense (benefit)	177	651	(21,847)
Net income (loss)	\$ (3,851)	\$ 6,718	\$ 38,598
Other comprehensive loss, net of tax			
Unrealized losses on securities, net of tax	—	—	(139)
Total other comprehensive loss, net of tax	—	—	(139)
Comprehensive income (loss)	\$ (3,851)	\$ 6,718	\$ 38,459
Net income (loss) per share:			
Basic	\$ (0.08)	\$ 0.13	\$ 0.74
Diluted	\$ (0.08)	\$ 0.12	\$ 0.70

Weighted-average shares used in computing net income (loss) per share:

Basic	50,913	51,415	52,425
Diluted	50,913	54,057	54,887

See accompanying notes to consolidated financial statements.

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## PAYLOCITY HOLDING CORPORATION

## Consolidated Statements of Changes in Stockholders' Equity

(in thousands)

	Stockholders' Equity				Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit		
Balances at June 30, 2015	50,703	\$ 51	\$ 155,672	\$ (48,143)	\$ —	\$ 107,580
Stock-based compensation	—	—	18,641	—	—	18,641
Stock options exercised	536	—	6,197	—	—	6,197
Issuance of common stock upon vesting of restricted stock units	120	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	102	—	2,991	—	—	2,991
Net settlement for taxes and/or exercise price related to equity awards	(329)	—	(11,986)	—	—	(11,986)
Net loss	—	—	—	(3,851)	—	(3,851)
Balances at June 30, 2016	51,132	\$ 51	\$ 171,515	\$ (51,994)	\$ —	\$ 119,572
Stock-based compensation	—	—	28,507	—	—	28,507
Stock options exercised	691	1	8,550	—	—	8,551
Issuance of common stock upon vesting of restricted stock units	255	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	127	—	3,677	—	—	3,677
Net settlement for taxes and/or exercise price related to equity awards	(467)	—	(19,859)	—	—	(19,859)
Excess tax benefits from stock-based compensation	—	—	447	—	—	447
Net income	—	—	—	6,718	—	6,718
Balances at June 30, 2017	51,738	\$ 52	\$ 192,837	\$ (45,276)	\$ —	\$ 147,613
Stock-based compensation	—	—	32,378	—	—	32,378

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Stock options exercised	839	1	8,001	—	—	8,002
Issuance of common stock upon vesting of restricted stock units	452	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	108	—	4,304	—	—	4,304
Net settlement for taxes and/or exercise price related to equity awards	(379)	—	(17,932)	—	—	(17,932)
Unrealized losses on securities, net of tax	—	—	—	—	(139)	(139)
Net income	—	—	—	38,598	—	38,598
Balances at June 30, 2018	52,758	\$ 53	\$ 219,588	\$ (6,678)	\$ (139)	\$ 212,824

See accompanying notes to consolidated financial statements.

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## PAYLOCITY HOLDING CORPORATION

## Consolidated Statements of Cash Flows

(in thousands)

	For the Years Ended June 30,		
	2016	2017	2018
Cash flows from operating activities:			
Net income (loss)	\$ (3,851)	\$ 6,718	\$ 38,598
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Stock-based compensation expense	17,563	26,734	30,354
Depreciation and amortization expense	13,873	21,027	30,202
Deferred income tax expense (benefit)	150	152	(21,870)
Provision for doubtful accounts	159	113	296
Net accretion of discounts and amortization of premiums on available-for-sale securities	—	—	(443)
Net realized losses on sales of available-for-sale securities	—	—	2
Loss on disposal of equipment	712	253	227
Changes in operating assets and liabilities:			
Accounts receivable	(725)	(472)	(1,494)
Prepaid expenses and other	(3,270)	(2,074)	(2,141)
Accounts payable	72	219	740
Accrued expenses	8,310	6,465	11,641
Tenant improvement allowance	—	2,845	11,754
Net cash provided by operating activities	32,993	61,980	97,866
Cash flows from investing activities:			
Purchases of available-for-sale securities from funds held for clients	—	—	(196,594)
Proceeds from sales and maturities of available-for-sale securities from funds held for clients	—	—	73,044
Net change in funds held for clients' cash and cash equivalents	(648,403)	297,163	(158,394)
Capitalized internal-use software costs	(8,391)	(13,641)	(15,638)
Purchases of property and equipment	(16,083)	(21,338)	(21,676)
Lease allowances used for tenant improvements	—	(2,845)	(11,754)
Acquisition of business, net of cash acquired	(483)	—	(8,346)
Net cash provided by (used in) investing activities	(673,360)	259,339	(339,358)
Cash flows from financing activities:			
Net change in client fund obligations	648,403	(297,163)	281,467
Proceeds from exercise of stock options	137	34	—
Proceeds from employee stock purchase plan	2,991	3,677	4,304

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Taxes paid related to net share settlement of equity awards	(5,926)	(11,342)	(10,554)
Excess tax benefits from stock-based compensation	—	447	—
Net cash provided by (used in) financing activities	645,605	(304,347)	275,217
Net Change in Cash and Cash Equivalents	5,238	16,972	33,725
Cash and Cash Equivalents—Beginning of Year	81,258	86,496	103,468
Cash and Cash Equivalents—End of Year	\$ 86,496	\$ 103,468	\$ 137,193
Supplemental Disclosure of Non-Cash Investing and Financing Activities			
Build-out allowances received from landlords	\$ 1,888	\$ —	\$ 1,956
Purchase of property and equipment and internal-use software, accrued but not paid	\$ 607	\$ 667	\$ 659
Supplemental Disclosure of Cash Flow Information			
Cash paid (refunds received) for income taxes	\$ 3	\$ 28	\$ (53)

See accompanying notes to consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Notes to the Consolidated Financial Statements

(all amounts in thousands, except per share data)

(1) Organization and Description of Business

Paylocity Holding Corporation (the “Company”) is a cloud-based provider of payroll and human capital management software solutions for medium-sized organizations. Services are provided in a Software-as-a-Service (“SaaS”) delivery model utilizing the Company’s cloud-based platform. Payroll services include collection, remittance and reporting of payroll liabilities to the appropriate federal, state and local authorities.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation, Consolidation, and Use of Estimates

The accompanying consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (the “SEC”).

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future events and their effects cannot be predicted with certainty; accordingly, accounting estimates require the exercise of judgment. Accounting estimates used in the preparation of these consolidated financial statements change as new events occur, as more experience is acquired, as additional information is obtained and as the operating environment changes.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

(b) Concentrations of Risk

The Company regularly maintains cash balances that exceed Federal Depository Insurance Corporation limits. No individual client represents 10% or more of total revenues. For all periods presented, 100% of total revenues were generated by clients in the United States.

(c) Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

(d) Funds Held For Clients, Corporate Investments and Client Fund Obligations

The Company obtains funds from clients in advance of performing payroll and payroll tax filing services on behalf of those clients. Funds held for clients represent assets that are used solely for the purposes of satisfying the obligations to remit funds relating to payroll and payroll tax filing services. The Company has classified funds held for clients as a current asset since these funds are held solely for the purposes of satisfying the client fund obligations. Funds held for clients is primarily comprised of cash and cash equivalents invested in demand deposit accounts. Starting in July 2017, the Company also invested a portion of its funds held for clients in marketable securities.

Marketable securities classified as available-for-sale are recorded at fair value on the consolidated balance sheets. Unrealized gains and losses, net of applicable income taxes, are reported as other comprehensive income (loss) in the consolidated statements of operations and comprehensive income (loss). Interest on marketable securities included in funds held for clients is reported as interest income on funds held for clients on the consolidated statements of operations and comprehensive income (loss).



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The Company reviews the composition of its portfolio for any available-for-sale security that has a fair value that falls below its amortized cost. If any security fits this criterion, the Company further evaluates whether other-than-temporary impairment exists by considering whether the Company has the intent and ability to retain the security for a period of time sufficient enough to allow for anticipated fair value recovery. The Company did not record any other-than-temporary impairment charges during the year ended June 30, 2018.

Client fund obligations represent the Company's contractual obligations to remit funds to satisfy clients' payroll and tax payment obligations and are recorded in the accompanying balance sheets at the time that the Company obtains funds from clients. The client fund obligations represent liabilities that will be repaid within one year of the balance sheet date.

## (e) Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on trade accounts receivable are included in net cash provided by operating activities in the statements of cash flows. The Company maintains an allowance for doubtful accounts reflecting estimated potential losses in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and the Company's clients' financial conditions, the amount of receivables in dispute, the current receivables aging and current payment patterns. The Company reviews its allowance for doubtful accounts quarterly. Past due balances over 60 days and over a specified amount are reviewed individually for collectability. All other balances are reviewed on a pooled basis. Account balances are charged off against the allowance after all commercially reasonable means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its clients.

Activity in the allowance for doubtful accounts was as follows:

	For the Years Ended June 30,		
	2016	2017	2018
Balance at the beginning of the year	\$ 149	\$ 193	\$ 266
Charged to expense	159	113	296
Write-offs	(115)	(40)	(187)
Balance at the end of the year	\$ 193	\$ 266	\$ 375

## (f) Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist primarily of tenant improvement allowance receivable from landlord, prepaid licensing fees, prepaid insurance premiums, deposits with vendors, corporate investments and time clocks available for sale or lease.

(g) Capitalized Internal-Use Software

The Company applies Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350-40, Intangibles—Goodwill and Other—Internal-Use Software, to the accounting for costs of internal-use software. Internal-use software costs are capitalized when application development begins, it is probable that the project will be completed, and the software will be used as intended. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. The Company also capitalizes certain costs related to specific upgrades and enhancements when it is probable the expenditures will result in significant additional functionality. The capitalization policy provides for the capitalization of certain payroll costs for employees who are directly associated with developing internal-use software as well as certain external direct costs, such as consulting fees. Capitalized employee costs are limited to the time directly spent on such projects.

Capitalized internal-use software costs are amortized on a straight-line basis over the estimated useful lives, generally over a 24 or 36-month period. Management evaluates the useful lives of these assets on an annual basis and tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

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(h) Property and Equipment and Long-Lived Assets

Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets, generally three to seven years for most classes of assets, or over the term of the related lease for leasehold improvements.

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group to be tested for possible impairment, the Company first compares the undiscounted cash flows expected to be generated by that asset or asset group to its carrying amount. If the carrying amount of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

(i) Intangible Assets, Net of Accumulated Amortization

Intangible assets are comprised primarily of client relationship acquisitions and are reported net of accumulated amortization on the consolidated balance sheets. Client relationships use the straight-line method of amortization over a seven or nine-year time frame from the date of acquisition, while non-solicitation agreements use the straight-line method of amortization over the term of the related agreements. The Company tests intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable.

(j) Goodwill

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is not amortized, but instead is tested for impairment at the reporting unit level. The Company adopted ASU 2017-04, Intangibles – Goodwill and Other for its annual goodwill impairment test performed during fiscal 2018. Based on the new standard, if the fair value of the reporting unit is less than its carrying amount, the Company would record an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, but the loss recognized should not exceed the amount of goodwill allocated to the reporting unit.

The Company performs its annual impairment review of goodwill in its fiscal fourth quarter or when a triggering event occurs between annual impairment tests. No impairment was recorded in fiscal 2016, 2017 or 2018 as a result of the Company's qualitative assessments over its single reporting segment.

(k) Deferred Rent

The Company has operating lease agreements for its office space, which contain provisions for future rent increases, periods of rent abatement and build-out allowances. The Company records monthly rent expense for each lease equal to the total payments due over the lease term, divided by the number of months of the lease term. Build-out allowances are recorded as part of leasehold improvements and the incentive is amortized over the lease term against depreciation. The difference between recorded rent expense and the amount paid is included in "Accrued expenses" and "Deferred rent" in the accompanying consolidated balance sheets.

(l) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Valuation allowances are provided when necessary to reduce deferred tax assets to the amount more likely than not to be realized. Significant management judgment is required in determining the period in which the reversal of a valuation allowance should occur. The Company is required to consider all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income among other items, in determining

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whether a full or partial release of its valuation allowance is required. The Company is also required to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance, which further requires the exercise of significant management judgment.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties as an element of income tax expense.

Refer to Note 11 for additional information on income taxes.

(m) Revenue Recognition

The Company recognizes revenue in accordance with ASC 605-25, Revenue Recognition—Multiple Element Arrangements, Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (“ASU 2009 13”), and Staff Accounting Bulletin 104, Revenue Recognition. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

The Company derives its revenue predominantly from recurring fees and non-recurring service fees. Recurring fees are collected under agreements for payroll, timekeeping, HR-related cloud-based computing services and monthly time clock rentals. While the majority of its agreements are generally cancellable by the client on 60 days’ notice or less, the Company began entering into term arrangements in fiscal 2018, which are generally over two years in length. Non-recurring service fees consist mainly of implementation and custom reporting services. Such fees are billed to clients and revenue is recorded upon completion of the service. The Company’s agreements do not include general rights of return and do not provide clients with the right to take possession of the software supporting the services being provided. As such, the agreements are accounted for as service contracts.

Interest income collected on funds held for clients is recognized in recurring revenues when earned as the collection, holding and remittance of these funds are critical components of providing these services.

Most multiple-element arrangements include a short implementation services phase, which involves establishing the client within and loading data into the Company’s cloud-based applications. Major recurring fees included in multiple-element arrangements include:

- Payroll processing and related services, including payroll reporting and tax filing services delivered on a weekly, biweekly, semi-monthly, or monthly basis depending upon the payroll frequency of the client and on an annual basis if a client selects W-2 preparation and processing services,
- Time and attendance reporting services, including time clock rentals, delivered on a monthly basis, and
- Cloud-based HR software solutions, including employee administration and benefits enrollment and administration, delivered on a monthly basis.

For each agreement, the Company evaluates whether the individual deliverables qualify as separate units of accounting. If one or more of the deliverables does not have standalone value upon delivery, the deliverables that do not have standalone value are generally combined and treated as a single unit of accounting by frequency of occurrence for the product category involved such as biweekly payroll or monthly timekeeping services. Revenues for arrangements treated as a single unit of accounting are generally recognized within the same month that the services are rendered.

In determining whether implementation services can be accounted for separately from recurring revenues, the Company considers the nature of the implementation services and the availability of the implementation services from other vendors. The Company was able to establish standalone value for implementation activities based on the historical activity of third-party vendors that performed these services and as such, accounts for such implementation services separate from the recurring revenues.

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If the recurring services have standalone value upon delivery, the Company accounts for each separately and revenues are recognized as services are delivered with allocation of consideration based on the relative selling price method as established in ASU 2009-13. That method requires the selling price of each element in a multiple-deliverable arrangement to be based on, in descending order: (i) vendor specific objective evidence of fair value (“VSOE”), (ii) third-party evidence of fair value (“TPE”) or (iii) management’s best estimate of the selling price (“BESP”).

The Company is not able to establish VSOE because the deliverables are sold across an insufficiently narrow range of prices on a stand-alone basis and is also not able to establish TPE because no third-party offerings are reasonably comparable to the Company’s offerings. The Company thus established its BESP by service offering, requiring the use of significant estimates and judgment. The Company considers numerous factors, including the nature of the deliverables themselves and the pricing and discounting practices utilized by the Company’s sales force. Arrangement consideration is allocated to each deliverable based on the established BESP and subject to the limitation that because the arrangements are cancellable with 60 days’ or less notice or additional consideration is contingent on the delivery of future services, recurring revenue is not allocated to any deliverable until the consideration has been earned, typically with each payroll cycle or monthly, depending on the service.

Revenues generated from sales through partners or utilizing partner services are recognized in accordance with the appropriate accounting guidance of ASC 605-45, Principal Agent Considerations. The Company reports revenue generated through partners or utilizing partner services at the gross amount billed to clients when (i) the Company is the primary obligor, (ii) the Company has latitude to establish the price charged and (iii) the Company bears the credit risk in the transaction.

Sales taxes collected from clients and remitted to governmental authorities where applicable are accounted for on a net basis and therefore are excluded from revenues in the statements of operations and comprehensive income (loss).

(n) Cost of Revenues

Cost of revenues consists primarily of the cost of recurring revenues and implementation services, which are expensed when incurred. Cost of revenues for recurring revenues consists primarily of costs to provide recurring services and support to the Company’s clients, and includes amortization of capitalized internal-use software. Cost of revenues for implementation services and other consists primarily of costs to provide implementation and other services.

(o) Advertising

Advertising costs are expensed as incurred. Advertising costs amounted to \$219, \$199 and \$179 for the years ended June 30, 2016, 2017 and 2018, respectively.

(p) Stock-Based Compensation

The Company recognizes all employee stock-based compensation as a cost in the financial statements. Equity-classified awards, including those under the 2014 Employee Stock Purchase Plan (“ESPP”), are measured at the grant date fair value of the award and expense is recognized, net of assumed forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. For stock options and estimated shares purchasable under the ESPP, the Company estimates grant date fair value using the Black-Scholes option-pricing model and periodically updates the assumed forfeiture rates for actual experience over their vesting term or the term of the ESPP purchase period.

(q) Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.



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(r) Segment Information

The Company's chief operating decision maker reviews the financial results of the Company in total when evaluating financial performance and for purposes of allocating resources. The Company has thus determined that it operates in a single cloud-based software solution reporting segment.

(s) Recently Adopted Accounting Standards

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718) (“ASU 2016-09”) which modifies accounting for excess tax benefits and tax deficiencies, forfeitures, and employer tax withholding requirements. ASU 2016-09 also clarifies certain classifications on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company adopted this standard effective July 1, 2017, and it resulted in an increase to the Company's gross net operating loss of \$30,783. As of December 31, 2017, the adoption of this standard did not have a material impact on its consolidated financial statements and disclosures due to the Company's valuation allowance on deferred tax assets. However, during the third quarter of fiscal 2018, the Company released its valuation allowance and as a result, the Company recorded a significant increase in deferred tax assets due to excess tax benefits from employee stock exercises. Refer to Note 11 for additional information on the release of the valuation allowance and the impact of excess tax benefits from employee stock exercises. The Company will continue to estimate forfeitures at each reporting period, rather than electing an accounting policy change to record the impact of such forfeitures as they occur.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805) (“ASU 2017-01”) which clarifies the definition of a business. ASU 2017-01 provides guidance to assist entities in evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. It is effective, on a prospective basis, for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company adopted this standard effective January 1, 2018. The adoption of ASU 2017-01 did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles – Goodwill and Other (Topic 350) (“ASU 2017-04”), which eliminated Step 2 of the goodwill impairment test, which required the impairment charge to be measured as a difference between the implied fair value of goodwill against its carrying amount. Instead, an entity measures goodwill impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The Company adopted this standard for the annual goodwill impairment test performed during fiscal 2018. The adoption of ASU 2017-04 did not have a material impact on the Company's financial statements.

In March 2018, the FASB issued ASU 2018-05, Income Taxes (Topic 740) (“ASU 2018-05”) which incorporates the SEC's Staff Accounting Bulletin 118 (“SAB 118”) issued on December 22, 2017. SAB 118 provides for a provisional

measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act (the “Act”), not to exceed one year from enactment of the new tax law. Entities are permitted to utilize reasonable estimates until they have finished analyzing the effects of the Act. The Company recognized provisional income tax effects of the Act during fiscal 2018 in accordance with SAB 118, and expects to complete its accounting under the Act by the end of December 2018. Refer to Note 11 for additional information.

(t) Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”). ASU 2014-09 supersedes a majority of existing revenue recognition guidance under US GAAP, and requires companies to recognize revenue when it transfers goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled. Companies may need to apply more judgment and estimation techniques or methods while recognizing revenue, which could result in additional disclosures to the financial statements. In addition, in March 2016, April 2016, May 2016 and December 2016 the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (“ASU 2016-08”), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (“ASU 2016-10”), ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”) and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers (“ASU 2016-20”), respectively, to amend certain guidance in ASU 2014-09. Topic 606 allows for either a retrospective or modified retrospective transition

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method. ASU 2014-09 was originally effective for fiscal years beginning after December 15, 2016. In July 2015, the FASB approved a one-year deferral of ASU 2014-09 and all amendments to it, with a new effective date for fiscal years beginning after December 15, 2017 with early adoption permitted as of the original effective date. The Company will adopt the new standard in its fiscal year beginning July 1, 2018 using the modified retrospective method of transition, which limits the application of the new standard only to contracts that were not completed as of the effective date of July 1, 2018. The Company is in the process of finalizing its accounting conclusions around the new standard as well as finalizing the impacts of the disclosure requirements and transition adjustments on its consolidated financial statements. The estimated impact is described below. The Company is also nearly complete in updating its existing internal controls and processes as it relates to the new standard.

Under the current revenue standard through fiscal 2018, the Company accounts for implementation and recurring services each as a separate unit of account. The Company has been able to establish standalone value for implementation services as supported by the activity of third-party resellers and other vendors that performed certain implementation services. The Company has observed that third party implementation activity has continued to decrease over time and at the same time, the Company has invested in proprietary applications and processes that impact implementation activities. The Company has determined that from July 1, 2018 forward it will no longer have a sufficient basis to establish standalone value of implementations for its proprietary products due to the culmination of the changes to the Company's applications and processes that eliminate the ability of third parties to perform implementation services. Similarly, the Company determined that these implementation services are not a separate performance obligation under the new standard for contracts entered into after July 1, 2018 and the associated implementation fees will be treated as nonrefundable upfront fees which will be deferred and amortized over a period of time instead of recognized upon completion.

The Company also has assessed the treatment of certain costs under the new standard and currently expects that there will be a material impact in the manner in which it treats both costs of obtaining new contracts (i.e., selling and commission costs) and direct costs of fulfillment. The Company will be required to defer these costs and amortize them over the expected period of benefit, which it has determined to be 7 years. The Company estimates that the cumulative effect related to the deferral of the costs of obtaining new contracts will be approximately \$51,000, net of deferred taxes, which will be recorded through Accumulated Deficit in the Statement of Changes in Stockholder's Equity upon adoption on July 1, 2018.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02") which amends various aspects of existing guidance for leases. ASU 2016-02 requires an entity to recognize assets and liabilities arising from a lease with terms greater than twelve months, along with additional qualitative and quantitative disclosures. ASU 2016-02 also requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented. In March 2018, the FASB affirmed its proposed ASU, Leases (Topic 842): Targeted Improvements, which provides an additional transition method allowing an entity to apply the new lease accounting and disclosure requirements only for the year of adoption with the comparative periods continuing to be in accordance with current GAAP. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. While the Company is still assessing the impact of the new standard, it expects the adoption of this standard will have a material effect on its consolidated balance sheets. The Company is evaluating the transition methods and will adopt this new standard in its fiscal year beginning July 1, 2019.

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of other recently issued standards that are not yet effective will not have a material impact on the Company's consolidated financial statements upon adoption.

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## (3) Funds Held for Clients and Corporate Investments

Investments consist of the following as of June 30, 2018:

Type of Issue	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Funds held for clients' cash and cash equivalents	\$ 1,102,541	\$ —	\$ (3)	\$ 1,102,538
Available-for-sale securities:				
Commercial paper	50,703	3	(4)	50,702
Corporate bonds	37,508	8	(134)	37,382
Asset-backed securities	25,901	1	(55)	25,847
U.S. treasury securities	9,879	—	(2)	9,877
Total available-for-sale securities	123,991	12	(195)	123,808
Investments	\$ 1,226,532	\$ 12	\$ (198)	\$ 1,226,346

Funds held for clients' cash and cash equivalents included demand deposit accounts, commercial paper and money market funds as of June 30, 2018.

Classification of investments on the consolidated balance sheets is as follows:

	Year ended June 30,	
	2017	2018
Funds held for clients	\$ 942,459	\$ 1,225,614
Prepaid expenses and other	—	732
Total investments	\$ 942,459	\$ 1,226,346

Available-for-sale securities that have been in an unrealized loss position for a period of less than 12 months as of June 30, 2018 had fair market values as follows:

	Gross unrealized losses	Fair value
Commercial paper	\$ (4)	\$ 23,657

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Corporate bonds	(134)	29,122
Asset-backed securities	(55)	17,960
U.S. treasury securities	(2)	4,933
Total available-for-sale securities	\$ (195)	\$ 75,672

As the Company started investing funds held for clients in available-for-sale securities during the year ended June 30, 2018, no securities have been in an unrealized loss position for more than 12 months. The Company did not make any material reclassification adjustments out of accumulated other comprehensive loss for realized gains and losses on the sale of available-for-sale securities during the year ended June 30, 2018. Gross realized gains and losses on the sale of available-for-sale securities were immaterial for the year ended June 30, 2018.

The Company regularly reviews the composition of its portfolio to determine the existence of other-than-temporary-impairment (“OTTI”). The Company did not recognize any OTTI charges in accumulated other comprehensive loss during the year ended June 30, 2018, nor does it believe that OTTI exists in its portfolio as of June 30, 2018. The Company plans to retain the securities in an unrealized loss position for a period of time sufficient enough to recover their amortized cost basis or until their maturity date. The Company believes that the unrealized losses on these securities were not due to deterioration in credit risk. The securities in an unrealized loss position held an A-1 rating or better as of June 30, 2018.

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Expected maturities of available-for-sale securities at June 30, 2018 are as follows:

	Amortized cost	Fair value
One year or less	\$ 99,420	\$ 99,319
One year to two years	22,571	22,487
Two years to three years	2,000	2,002
Total available-for-sale securities	\$ 123,991	\$ 123,808

## (4) Fair Value Measurement

The Company applies the fair value measurement and disclosure provisions of ASC 820, Fair Value Measurements and Disclosures, and ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1—Quoted prices in active markets for identical assets and liabilities.
- Level 2—Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Company measures any cash and cash equivalents, accounts receivable, accounts payable and client fund obligations at fair value on a recurring basis using Level 1 inputs. The Company considers the recorded value of these financial assets and liabilities to approximate the fair value of the respective assets and liabilities at June 30, 2017 and June 30, 2018 based upon the short-term nature of these assets and liabilities.

Marketable securities, consisting of securities classified as available-for-sale as well as certain cash equivalents, are recorded at fair value on a recurring basis using Level 2 inputs obtained from an independent pricing service. Available-for-sale securities include commercial paper, corporate bonds, asset-backed securities and US treasury securities. The independent pricing service utilizes a variety of inputs including benchmark yields, broker/dealer quoted prices, reported trades, issuer spreads as well as other available market data. The Company, on a sample basis, validates the pricing from the independent pricing service against another third-party pricing source for reasonableness. The Company has not adjusted any prices obtained by the independent pricing service, as it believes they are appropriately valued. There were no available-for-sale securities classified in Level 3 of the fair value hierarchy at June 30, 2018, and the Company did not transfer assets between Levels during the year ended June 30, 2018. The Company did not hold any marketable securities at June 30, 2017.

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The fair value level for the funds held for clients' cash and cash equivalents and available-for-sale securities as of June 30, 2018 is as follows:

	Total	Level 1	Level 2	Level 3
Funds held for clients' cash and cash equivalents	\$ 1,102,538	\$ 1,076,414	\$ 26,124	\$ —
Available-for-sale securities:				
Commercial paper	50,702	—	50,702	—
Corporate bonds	37,382	—	37,382	—
Asset-backed securities	25,847	—	25,847	—
U.S. treasury securities	9,877	—	9,877	—
Total available-for-sale securities	123,808	—	123,808	—
Investments	\$ 1,226,346	\$ 1,076,414	\$ 149,932	\$ —

## (5) Business Combinations

In March 2018, the Company acquired substantially all the assets of BeneFLEX HR Resources, Inc. (“BeneFLEX”), a third party employee benefits administrator, for \$9,346, net of cash acquired. BeneFLEX administers employee benefit plans, including flexible spending accounts, health savings accounts, health reimbursement accounts, COBRA, and others. The Company paid \$8,346 upon closing and may be required to pay an additional \$1,000 subject to BeneFLEX attaining certain revenue targets and in the absence of indemnity claims. This acquisition expands the portfolio of services available to the Company’s clients by allowing it to provide additional benefit administration solutions to its clients, prospects, and broker partners.

The Company accounts for business combinations in accordance with ASC 805 (Business Combinations). The Company recorded the acquisition using the acquisition method of accounting and recognized assets at their fair value as of the date of acquisition. The Company determined the fair value of identifiable intangible assets acquired primarily by using an income approach.

The following table summarizes the allocation of the purchase price for BeneFLEX:

	At March
	8, 2018
Goodwill	\$ 3,587
Client relationships	5,550
Non-solicitation agreements	240
Net liabilities assumed	(31)
Total purchase price	\$ 9,346

The results from this acquisition have been included in the Company's consolidated financial statements since the closing of the acquisition. Pro forma information has not been presented because the effect of the acquisition is not material to the Company's consolidated financial statements. Goodwill will be amortized over a period of 15 years for income tax purposes. Direct costs related to the acquisitions were recorded as general and administrative expenses as incurred.

#### (6) Capitalized Internal-Use Software

Capitalized internal-use software and accumulated amortization were as follows:

	Year ended June 30,	
	2017	2018
Capitalized internal-use software	\$ 49,663	\$ 67,678
Accumulated amortization	(32,269)	(46,584)
Capitalized internal-use software, net	\$ 17,394	\$ 21,094

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Amortization of capitalized internal-use software amounted to \$5,446, \$9,447 and \$14,315 for the years ended June 30, 2016, 2017 and 2018, respectively and is included in Cost of Revenues—Recurring Revenues.

(7) Property and Equipment

The major classes of property and equipment are as follows as of June 30:

	Year ended June 30,	
	2017	2018
Office equipment	\$ 3,591	\$ 3,743
Computer equipment	24,411	29,768
Furniture and fixtures	7,547	10,382
Software	4,954	5,965
Leasehold improvements	21,426	36,366
Time clocks rented by clients	4,240	4,534
Total	66,169	90,758
Accumulated depreciation	(25,413)	(28,729)
Property and equipment, net	\$ 40,756	\$ 62,029

Depreciation expense amounted to \$6,905, \$10,068 and \$14,192 for the years ended June 30, 2016, 2017 and 2018, respectively.

(8) Goodwill and Intangible Assets

The following table summarizes changes in goodwill during the year ended June 30, 2018:

Balance at June 30, 2017	\$ 6,003
Additions attributable to current year acquisition	3,587
Balance at June 30, 2018	\$ 9,590

The Company's amortizable intangible assets and estimated useful lives are as follows:

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	June 30, 2017	June 30, 2018	Useful Life
Client relationships	\$ 12,580	\$ 18,130	7 - 9 years
Non-solicitation agreements	360	600	2 - 4 years
Total	12,940	18,730	
Accumulated amortization	(4,033)	(5,728)	
Intangible assets, net	\$ 8,907	\$ 13,002	

The increase in goodwill and intangible assets is related to the acquisition of BeneFLEX as discussed in Note 5. Amortization expense for acquired intangible assets was \$1,522, \$1,512 and \$1,695 for the years ended June 30, 2016, 2017 and 2018, respectively. Future amortization expense for acquired intangible is as follows, as of June 30, 2018:

Year ending June 30,	
2019	\$ 2,251
2020	2,251
2021	2,251
2022	2,232
2023	2,118
Thereafter	1,899
Total	\$ 13,002

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## (9) Accrued Expenses

The components of accrued expenses are as follows:

	Year ended June 30,	
	2017	2018
Accrued payroll and personnel costs	\$ 25,131	\$ 31,206
Lease exit obligations	—	2,143
Other	5,170	8,892
Total accrued expenses	\$ 30,301	\$ 42,241

## (10) Leases

The Company primarily leases office space in Illinois, California, Florida, Idaho, New Jersey, New Hampshire, New York, Michigan and Missouri under non-cancellable operating leases expiring on various dates from July 2018 through October 2032. The leases provide for increasing annual base rents and oblige the Company to fund proportionate share of operating expenses and, in certain cases, real estate taxes. The Company also leases various types of office and production related equipment under non-cancellable operating leases expiring on various dates from January 2019 through June 2022.

In June 2016, the Company entered into a lease for approximately 310 rentable square feet of office space located in Schaumburg, Illinois. The Company currently utilizes the leased premises as its headquarters, relocating from its previous headquarters in Arlington Heights, Illinois in the fourth quarter of fiscal 2018. The lease provided for phased delivery and commencement dates, and the Company commenced each phase on the following dates: Phase I (June 1, 2017), Phase II (November 1, 2017) and Phase III (July 1, 2018). The Company expects to commence Phase IV on July 1, 2019 with the actual commencement date subject to timely delivery of the premises by the landlord. Under the terms of the lease, the Company receives a tenant improvement allowance equal to \$65.00 per rentable square foot and a 12-month rent abatement period for each lease phase. The lease began on the Phase I commencement date (June 1, 2017) and will end on October 31, 2032 with two subsequent five-year renewal options.

In February 2017, the Company entered into a lease for approximately 62 rentable square feet of office space located in Meridian, Idaho. The Company uses the leased premises to accommodate the continued expansion of its employee base in the western region of the United States. The lease provided for phased delivery and commencement dates and the Company commenced Phase I on July 2, 2018. The Company expects to commence Phase II on February 1, 2020 with the actual commencement date subject to timely delivery of the premises by the landlord. Under the terms of the

lease, the Company receives a tenant improvement allowance equal to \$50.00 per rentable square foot and a 3-month rent abatement period for each lease phase. The lease began on the Phase I commencement date (July 2, 2018) and will end on July 31, 2028 with four subsequent five-year renewal options.

In June 2018, the Company ceased using approximately 110 rentable square feet of its former headquarters in Arlington Heights, Illinois in conjunction with relocating to its new Schaumburg, Illinois headquarters. As a result, the Company recognized \$2,336 in early lease exit costs that are included in general and administrative expense in its consolidated statements of operations and comprehensive income (loss).

The following table is a summary of the changes in the remaining lease obligation related to the former headquarters, which is recorded in accrued expenses and other long-term liabilities on the consolidated balance sheet. The difference between the lease exit costs recognized in general and administrative expense as discussed above and the remaining lease obligation relates to the write-off of deferred rent recorded in prior periods.

Balance at June 30, 2017	\$ —
Additions	3,446
Payments	(199)
Adjustments	14
Balance at June 30, 2018	\$ 3,261

Minimum rent payments under operating leases are recognized on a straight-line basis over the term of the lease including any periods of free rent and future rent increases. Rental expense for operating leases, including amortization

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of leasehold improvements, was \$5,596, \$8,571 and \$12,293 for the years ended June 30, 2016, 2017 and 2018, respectively.

Future minimum lease payments under non-cancellable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2018 are:

Year ending June 30,	
2019	\$ 8,909
2020	9,077
2021	10,126
2022	8,803
2023	8,345
Later years, through 2032	67,225
Total minimum lease payments	\$ 112,485

## (11) Income Taxes

## (a) Income Taxes

Income tax expense (benefit) for the years ended June 30, 2016, 2017 and 2018 consists of the following:

	Year ended June 30,		
	2016	2017	2018
Current taxes			
U.S. federal	\$ —	\$ —	\$ 294
State and local	27	500	364
Deferred taxes:			
U.S. federal	136	137	(15,167)
State and local	14	14	(7,338)
Total income tax expense (benefit)	\$ 177	\$ 651	\$ (21,847)

## (b) Tax Rate Reconciliation

Income tax expense (benefit) differed from the amounts computed by applying the U.S. federal income tax rate of 34% for the years ended June 30, 2016 and 2017, and 27.55% for the year ended June 30, 2018 to pretax income (loss) as a result of the following:

	Year ended June 30,		
	2016	2017	2018
Income tax expense (benefit) at statutory federal rate	\$ (1,249)	\$ 2,503	\$ 4,615
Increase (reduction) in income taxes resulting from:			
Research and development credit, net of federal income tax benefit	(504)	(1,025)	(1,101)
Non-deductible expenses	557	685	1,531
Change in valuation allowance	2,590	(1,349)	(22,771)
Effect of Tax Cuts and Jobs Act			8,626
Stock-based compensation expense			(10,527)
State and local income taxes, net of federal income tax benefit	(432)	(196)	(2,262)
Other	(785)	33	42
	\$ 177	\$ 651	\$ (21,847)

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## (c) Components of Deferred Tax Assets and Liabilities

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2017 and 2018 are presented below.

	Year ended June 30,	
	2017	2018
Deferred tax assets:		
Deferred rent	\$ 1,090	\$ 1,177
Accrued expenses	2,290	2,709
Stock-based compensation	11,034	10,833
Net operating loss carryforwards	253	10,775
Research and development and other credits	4,984	7,674
Intangible assets	256	271
Other	129	146
Total deferred tax assets	20,036	33,585
Valuation allowance	(8,689)	(355)
Net deferred tax assets	11,347	33,230
Deferred tax liabilities:		
Research and development costs	(5,649)	(4,711)
Depreciation	(6,099)	(6,379)
Total deferred tax liabilities	(11,748)	(11,090)
Net deferred tax asset (liability)	\$ (401)	\$ 22,140

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized through the generation of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income and tax-planning strategies in making this assessment. The Company established a valuation allowance in fiscal 2014 on all of its net deferred tax assets except for deferred tax liabilities associated with indefinite-lived intangible assets, given that the Company determined that it was more likely than not that the Company would not recognize the benefits of its net operating loss carryforwards prior to their expiration. The Company continued to record a valuation allowance through the first six months of fiscal 2018. In the third quarter of fiscal 2018, management concluded that all of the valuation allowance for the Company's U.S. federal deferred tax assets and substantially all state deferred tax assets was no longer needed. This is primarily due to three years' cumulative income through the third quarter of fiscal 2018 and the forecast of future taxable income. At March 31, 2018, based on the evaluation of positive and negative evidence, management believed it is more likely than not that the net deferred tax assets will be realized for all federal and substantially all state purposes. Accordingly, management recognized a non-recurring tax benefit of \$22,585 related to the valuation allowance reversal. As of June 30, 2018, the Company continues to maintain a valuation allowance of \$355 for certain state tax benefits. Such assessment may change in the future as further evidence becomes available.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was signed into law. Over the long term, the Company generally expects to benefit from the lower statutory rates provided by the Act and is currently assessing all other aspects relevant to the Company. The Company operates solely in the United States; therefore, the international provisions of the Act do not apply. In accordance with ASC 740, during the second quarter the Company modified its current federal statutory rate for the year to account for the rate change. At that time, the Company recorded a \$156 income tax benefit attributable to the rate change effect on the deferred tax liability for indefinite-lived intangible assets.

In response to the Act, the SEC subsequently issued SAB 118 (later codified into ASU 2018-05) allowing registrants to record provisional amounts to the extent a company's accounting for the Act is incomplete. Pursuant to disclosure under SAB 118, revaluation of deferred taxes as of December 22, 2017 is incomplete. The Company has recorded provisional estimated tax expense of \$8,626 related to the rate change and additional limitations on executive compensation. As the Company released substantially all of its valuation allowance against its deferred taxes, this expense is included in the income tax (benefit) for the year. As of June 30, 2018, the Company is still analyzing the impact of the Act with respect to limitations on the deductibility of executive compensation and certain aspects of bonus depreciation expense. The Company needs additional time to finalize its estimates and expects additional guidance to be

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issued by the Internal Revenue Service before the assessment of the impact of the Act can be completed. The Company currently expects to complete its accounting for the effects of the Act by the end of December 2018.

At June 30, 2018, the Company has gross net operating loss carryforwards for federal income tax purposes of approximately \$45,839 and state income tax purposes of approximately \$18,409. The federal NOL carryforwards expire from 2029 to 2038. The state NOL carryforwards expire from 2019 to 2038. The Company also has gross federal and state research and development tax credit and other state credit carryforwards of approximately \$7,674, which expire between 2018 and 2038.

The Company had no unrecognized tax benefits as of June 30, 2016, 2017 and 2018, respectively.

The Company files income tax returns with the United States federal government and various state jurisdictions. Certain tax years remain open for federal and state tax reporting jurisdictions in which the Company does business due to net operating loss carryforwards and tax credits unutilized from such years or utilized in a period remaining open for audit under normal statute of limitations relating to income tax liabilities. The Company, including its domestic subsidiary, files a consolidated federal income tax return. For years before 2014 (fiscal year ended June 30, 2015), the Company is no longer subject to U.S. federal examination; however, the Internal Revenue Service (IRS) has the ability to review years prior to 2014 to the extent the Company utilized tax attributes carried forward from those prior years. The statute of limitations on state filings is generally three to four years.

(12) Stockholders' Equity

Common Stock

Holders of common stock are entitled to one vote per share and to receive dividends, when declared. The holders have no preemptive or other subscription rights and there are no redemption or sinking fund provisions with respect to such shares.

(13) Benefit Plans

(a) Equity Incentive Plans

The Company maintains a 2008 Equity Incentive Plan (the “2008 Plan”) and a 2014 Equity Incentive Plan (the “2014 Plan”) pursuant to which the Company has reserved shares of its common stock for issuance to its employees, directors and non-employee third parties. The 2014 Plan serves as the successor to the 2008 Plan and permits the granting of options to purchase common stock and other equity incentives at the discretion of the compensation committee of the Company’s board of directors. No new awards have been or will be issued under the 2008 Plan since the effective date of the 2014 Plan. Outstanding awards under the 2008 Plan continue to be subject to the terms and conditions of the 2008 Plan. The number of shares of common stock reserved for issuance under the 2014 Plan will increase automatically each calendar year, continuing through and including January 1, 2024 (the “Evergreen provision”). The number of shares added each year will be equal to the lesser of (a) four and five tenths percent (4.5%) of the number of shares of common stock of the Company issued and outstanding on the immediately preceding December 31, or (b) an amount determined by the Company’s board of directors. The Company’s board of directors determined that, effective January 1, 2018, it would increase the number of common shares in reserve for issuance under the 2014 Plan by 2,367 shares.

As of June 30, 2018, the Company had 13,816 shares allocated to the plans, of which 3,786 shares were subject to outstanding options or awards. Generally, the Company issues previously unissued shares for the exercise of stock options or vesting of awards; however, shares previously subject to 2014 Plan grants or awards that are forfeited or not settled at exercise or release may be reissued to satisfy future issuances.

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The following table summarizes the changes in the number of shares available for grant under the Company's equity incentive plans during the year ended June 30, 2018:

	Number of Shares
Available for grant at July 1, 2017	8,227
January 1, 2018 Evergreen provision increase	2,367
RSUs granted	(929)
Shares withheld in settlement of taxes and/or exercise price	379
Forfeitures	58
Shares removed	(72)
Available for grant at June 30, 2018	10,030

Shares removed represents forfeitures of shares and shares withheld in settlement of taxes and/or payment of exercise price related to grants made under the 2008 Plan. As noted above, no new awards will be issued under the 2008 Plan.

Stock-based compensation expense related to stock options, restricted stock units ("RSUs"), and the Employee Stock Purchase Plan (as described below) is included in the following line items in the accompanying audited consolidated statements of operations and comprehensive income (loss):

	Year ended June 30,		
	2016	2017	2018
Cost of revenue – recurring	\$ 1,648	\$ 2,162	\$ 2,830
Cost of revenue – non-recurring	1,127	1,357	1,388
Sales and marketing	4,441	6,287	7,295
Research and development	2,789	3,086	3,748
General and administrative	7,558	13,842	15,093
Total stock-based compensation expense	\$ 17,563	\$ 26,734	\$ 30,354

In addition, the Company capitalized \$1,078, \$1,773 and \$2,024 of stock-based compensation expense in its capitalized internal-use software costs in the years ended June 30, 2016, 2017 and 2018, respectively.

In June 2017, Peter McGrail ceased to serve as the Company's Chief Financial Officer, but continued to serve as an employee of the Company. In connection with Mr. McGrail's modified employment arrangement, the compensation committee of the Board of Directors approved modifications to terms of the unvested equity awards granted to Mr. McGrail. Any awards held by Mr. McGrail that were subject to time-based vesting became fully-vested upon his death.

in August 2017. Additionally, any performance-based restricted stock unit (“PSU”) awards held by Mr. McGrail will continue to vest and settle based upon actual achievement of previously-established performance metrics, with Mr. McGrail receiving a pro-rata share of the PSU awards based on the number of days Mr. McGrail was employed over the vesting period. As a result of these award modifications, the Company recognized \$2,925 in additional stock-based compensation expense for the fiscal year ended June 30, 2017, which was included in general and administrative expense in the Company’s consolidated statements of operations and comprehensive income (loss).

Under the 2008 and 2014 Plans, the exercise price of each option cannot be less than the fair value of a share of common stock on the grant date. The options typically vest ratably over a three or four year period and expire 10 years from the grant date. Stock-based compensation expense for the fair value of the options at their grant date is recognized ratably over the vesting schedule for each separately vesting portion of the award.

The Company values stock options using the Black-Scholes option-pricing model, which requires the input of subjective assumptions, including the risk-free interest rate, expected life, expected stock price volatility and dividend yield. The risk-free interest rate assumption is based upon observed interest rates for U.S. Treasury securities consistent with the expected term of the Company’s employee stock options. The expected life represents the period of time the stock options are expected to be outstanding and is based on the simplified method. Under the simplified method, the expected life of an option is presumed to be the mid-point between the vesting date and the end of the contractual term. As the Company has a limited history of trading as a public company, the Company utilizes the simplified method due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to otherwise estimate the expected

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life of the stock options. Therefore, the expected volatility is based on historical volatilities for publicly traded stock of comparable companies over the estimated expected life of the stock options. The Company assumed no dividend yield because it does not expect to pay dividends in the near future, which is consistent with the Company's history of not paying dividends.

There were no stock options granted during the years ended June 30, 2017 or 2018. The following table summarizes the assumptions used for estimating the fair value of stock options granted for the year ended June 30, 2016:

Valuation assumptions:	
Expected dividend yield	0 %
Expected volatility	34.0%
Expected term (years)	6.25
Risk-free interest rate	1.83%

Stock option activity during the periods indicated is as follows:

	Outstanding Options			Aggregate intrinsic value
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (years)	
Balance at July 1, 2017	2,751	\$ 11.54	5.69	\$ 92,556
Options forfeited	(5)	\$ 18.41		
Options exercised	(839)	\$ 9.54		
Balance at June 30, 2018	1,907	\$ 12.40	5.00	\$ 88,595
Options exercisable at June 30, 2018	1,781	\$ 11.18	4.89	\$ 84,935
Options vested and expected to vest at June 30, 2018	1,905	\$ 12.37	5.00	\$ 88,538

There were no stock options granted during the years ended June 30, 2017 or 2018. The weighted average grant date fair value of options granted during the year ended June 30, 2016 was \$12.92. The total intrinsic value of options exercised during the years ended June 30, 2016, 2017 and 2018 was \$13,362, \$20,802 and \$34,083, respectively. At June 30, 2018, there was \$152 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested stock options granted under the Plan. That cost is expected to be recognized over a weighted average period of 0.84 years.

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The following table summarizes information about stock options outstanding and stock options exercisable at June 30, 2018:

Price Range	Options Outstanding			Options Exercisable	
	Number of shares	Weighted average remaining contractual term	Weighted average exercise price	Number of shares	Weighted average exercise price
\$2.28 to \$3.58	73	2.92	\$ 2.28	73	\$ 2.28
\$3.59 to \$5.96	847	4.14	\$ 4.88	847	\$ 4.88
\$5.97 to \$12.02	127	5.02	\$ 7.04	127	\$ 7.04
\$12.03 to \$20.90	521	5.72	\$ 17.00	521	\$ 17.00
\$20.91 to \$35.28	339	6.47	\$ 28.32	213	\$ 27.50
Total	1,907	5.00	\$ 12.40	1,781	\$ 11.18

The Company may also grant RSUs under the 2014 Plan with terms determined at the discretion of the compensation committee of the Company's board of directors. RSUs generally vest over three or four years following the grant date. Certain RSU awards have time-based vesting conditions while other RSUs vest based on the achievement

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of certain revenue and Adjusted EBITDA targets in future fiscal years. The following table represents restricted stock unit activity during the year ended June 30, 2018:

	Units	Weighted average grant date fair value
RSU balance at July 1, 2017	1,455	\$ 39.96
RSUs granted	929	\$ 46.61
RSUs vested	(452)	\$ 39.30
RSUs forfeited	(53)	\$ 42.08
RSU balance at June 30, 2018	1,879	\$ 43.39
RSUs expected to vest at June 30, 2018	1,667	\$ 43.23

At June 30, 2018, there was \$29,656 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested restricted stock units granted. That cost is expected to be recognized over a weighted average period of 1.85 years.

The total excess income tax benefits for stock-based compensation arrangements was \$8,228, \$15,130 and \$33,443 for the years ended June 30, 2016, 2017 and 2018, respectively. As described in Note 2, the Company adopted ASU 2016-09 as of July 1, 2017. As a result, the Company recognized these tax benefits through income tax expense instead of additional paid-in capital.

**(b) Employee Stock Purchase Plan**

Under the Company's Employee Stock Purchase Plan ("ESPP"), the Company can grant stock purchase rights to all eligible employees during specific offering periods not to exceed twenty-seven months. Each offering period will begin on the trading day closest to May 16 and November 16 of each year. Shares are purchased through employees' payroll deductions, up to a maximum of 10% of employees' compensation for each purchase period, at a purchase price equal to 85% of the lesser of the fair market value of the Company's common stock at the first trading day of the applicable offering period or the purchase date. Participants may purchase up to \$25 worth of common stock or 2 shares of common stock in any one year. The ESPP is considered compensatory and results in compensation expense.

As of June 30, 2018, a total of 1,111 shares of common stock were reserved for future issuances under the ESPP. The number of shares of common stock reserved for issuance under the ESPP will increase automatically each calendar year, continuing through and including January 1, 2024. The number of shares added each year will be equal to the lesser of (a) 400, (b) seventy-five one hundredths percent (0.75%) of the number of shares of common stock of the Company issued and outstanding on the immediately preceding December 31, or (c) an amount determined by the Company's board of directors. The Company's board of directors determined that, effective January 1, 2018, it would increase the number of common shares in reserve for issuance under the ESPP by 395 shares.

The Company issued a total of 108 shares upon the completion of its six-month offering periods ending November 15, 2017 and May 15, 2018. The Company recorded compensation expense attributable to the ESPP of \$1,069, \$1,263 and \$1,331 for the years ended June 30, 2016, 2017 and 2018, respectively, which is included in the summary of stock-based compensation expense above. The grant date fair value of the ESPP offering periods was estimated using

the following weighted average assumptions:

	Year ended June 30,		
	2016	2017	2018
Valuation assumptions:			
Expected dividend yield	0 %	0 %	0 %
Expected volatility	44.1 - 53.4 %	38.9 - 53.4 %	28.3 - 39.1 %
Expected term (years)	0.5	0.5	0.5
Risk-free interest rate	0.11 - 0.31 %	0.28 - 1.02 %	1.02 - 2.10 %

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(c) 401(k) Plan

The Company maintains a 401(k) plan with a matching provision that covers all eligible employees. Up to December 31, 2015, the Company matched 50% of the employees' contributions up to 6% of their gross pay. Effective January 1, 2016, the Company increased its match to 50% of employees' contributions up to 8% of their gross pay. Contributions were \$2,717, \$3,667 and \$4,632 for the years ended June 30, 2016, 2017 and 2018, respectively.

(14) Commitments and Contingencies

(a) Employment Agreements

The Company has employment agreements with certain of its key officers. The agreements allow for minimum annual compensation increases, participation in equity incentive plans and bonuses for annual performance as well as certain change of control events as defined in the agreements.

(b) Litigation

From time to time, the Company is subject to litigation arising in the ordinary course of business. Many of these proceedings are covered in whole or in part by insurance. In the opinion of the Company's management, the ultimate disposition of any matters currently outstanding or threatened will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

(15) Net Income (Loss) Per Share

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, the release of restricted stock units and the shares purchasable via the employee stock purchase plan as of the balance sheet date.

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The following table presents the calculation of basic and diluted net income (loss) per share:

	Year ended June 30,		
	2016	2017	2018
Numerator:			
Net income (loss)	\$ (3,851)	\$ 6,718	\$ 38,598
Denominator:			
Weighted-average shares used in computing net income (loss) per share:			
Basic	50,913	51,415	52,425
Weighted-average effect of potentially dilutive shares:			
Employee stock options, restricted stock units and employee stock purchase plan shares	—	2,642	2,462
Diluted	50,913	54,057	54,887
Net income (loss) per share:			
Basic	\$ (0.08)	\$ 0.13	\$ 0.74
Diluted	\$ (0.08)	\$ 0.12	\$ 0.70

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The following table summarizes the outstanding employee stock options, restricted stock units and employee stock purchase plan shares as of the balance sheet date that were excluded from the diluted per share calculation for the periods presented because to include them would have been anti-dilutive:

	Year ended June 30,		
	2016	2017	2018
Employee stock options	3,464	145	—
Restricted stock units	1,003	627	92
Employee stock purchase plan shares	15	14	—
Total	4,482	786	92

(16) Selected Quarterly Financial Data (unaudited)

The following tables set forth selected unaudited quarterly statements of operations data for each of the eight quarters in the years ended June 30, 2017 and 2018.

Consolidated Statements of Operations Data	Quarter Ended		March 31, 2017	June 30, 2017
	September 30, 2016	December 31, 2016		
Revenues	\$ 65,022	\$ 68,654	\$ 90,273	\$ 76,061
Gross profit	\$ 36,663	\$ 38,271	\$ 58,191	\$ 42,898
Operating income (loss)	\$ (2,507)	\$ (1,643)	\$ 14,880	\$ (3,434)
Net income (loss)	\$ (2,568)	\$ (1,671)	\$ 14,801	\$ (3,844)
Net income (loss) per share:				
Basic	\$ (0.05)	\$ (0.03)	\$ 0.29	\$ (0.07)
Diluted	\$ (0.05)	\$ (0.03)	\$ 0.27	\$ (0.07)
Weighted-average shares used in computing net income (loss) per share:				
Basic	51,231	51,384	51,447	51,602
Diluted	51,231	51,384	54,002	51,602

Consolidated Statements of Operations Data	Quarter Ended		March 31, 2018	June 30, 2018
	September 30, 2017	December 31, 2017		
Revenues	\$ 81,500	\$ 86,004	\$ 113,407	\$ 96,616

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Gross profit	\$ 46,541	\$ 49,164	\$ 74,755	\$ 57,870
Operating income (loss)	\$ 515	\$ 133	\$ 20,465	\$ (5,164)
Net income (loss)	\$ 543	\$ 431	\$ 39,177	\$ (1,553)
Net income (loss) per share:				
Basic	\$ 0.01	\$ 0.01	\$ 0.74	\$ (0.03)
Diluted	\$ 0.01	\$ 0.01	\$ 0.71	\$ (0.03)
Weighted-average shares used in computing net income (loss) per share:				
Basic	51,893	52,502	52,615	52,699
Diluted	54,610	54,818	55,030	52,699

(17) Subsequent Events

On August 9, 2018, the Company announced that its Board of Directors approved a stock repurchase plan under which it is authorized to purchase (in the aggregate) up to \$35,000 of its issued and outstanding common stock, over a 12-month period. Shares may be repurchased from time-to-time in open market transactions at prevailing market prices or privately negotiated transactions. The actual timing, number and value of shares repurchased will depend on the market price of its common stock, general market conditions and other corporate and economic considerations.

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