

Benefitfocus, Inc.  
Form 10-K  
February 27, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2014

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: 001-36061

**Benefitfocus, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**46-2346314**  
(I.R.S. Employer  
Identification No.)

**100 Benefitfocus Way**

**Charleston, South Carolina 29492**

(Address of principal executive offices and zip code)

**(843) 849-7476**

(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 of which registered
Common Stock, \$0.001 Par Value	NASDAQ Global Market

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

None

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

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 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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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 the registrant's common stock held by non-affiliates of the registrant on June 30, 2014 (based on the closing sale price of \$46.22 on that date), was approximately \$318,751,978. Common stock held by each officer and director and by each person known to the registrant who owned 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant's common stock outstanding as of February 24, 2015 was 28,459,860.

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### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its 2015 Annual Meeting of Stockholders currently scheduled to be held on June 12, 2015 are incorporated by reference into Part III hereof.

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**Form 10-K**

**For Year Ended December 31, 2014**

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**PART I**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Annual Report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Such forward-looking statements include any expectation of earnings, revenue or other financial items; any statements of the plans, strategies and objectives of management for future operations; factors that may affect our operating results; statements about our ability to establish and maintain intellectual property rights; statements about our ability to retain and hire necessary associates and appropriately staff our operations; statements related to future capital expenditures; statements related to future economic conditions or performance; statements as to industry trends; and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. Forward-looking statements are often identified by the use of words such as, but not limited to, anticipate, believe, can, continue, could, estimate, expect, intend, may, might, will, plan, project, seek, should, target, variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled Risk Factors included in Item 1A of Part I of this Annual Report on Form 10-K, and the risks discussed in our other SEC filings. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

As used in this report, the terms Benefitfocus, Inc., Benefitfocus, Company, company, we, us, and our mean Benefitfocus, Inc. and its subsidiaries unless the context indicates otherwise.

***Item 1. Business***

**Overview**

Benefitfocus is a leading provider of cloud-based benefits software solutions for consumers, employers, insurance carriers, and brokers. The Benefitfocus platform provides an integrated suite of solutions that enables our employer and insurance carrier customers to more efficiently shop, enroll, manage, and exchange benefits information. Our web-based platform has a user-friendly interface designed to enable the insured consumers to access all of their benefits in one place. Our comprehensive solutions support core benefits plans, including healthcare, dental, life, and disability insurance, and voluntary benefits plans, such as critical illness, supplemental income, and wellness programs. As the number of employer benefits plans has increased, with each plan subject to many different business rules and requirements, demand for the Benefitfocus platform has grown.

The Benefitfocus platform enables our customers to simplify the management of complex benefits processes, from sales through enrollment and implementation to ongoing administration. It provides consumers with an engaging, highly intuitive, and personalized user interface for selecting and managing all of their benefits via the web or mobile devices. Employers use our solutions to streamline benefits processes, keep up with complex regulatory requirements, control costs, and offer a greater

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variety of plans to attract, retain, and motivate their employees. Insurance carriers use our solutions to more effectively market offerings, manage billing, and improve the enrollment process. We also provide a network of over 900 benefit provider data exchange connections, which facilitates the otherwise highly fragmented interaction among employees, employers, and carriers.

We serve two separate but related market segments. Our fastest growing market segment, the employer market, consists of employers offering benefits to their employees. Within this segment, we mainly target large employers with more than 1,000 employees, of which we believe there are approximately 18,000 in the United States. In our other market segment, we sell our solutions to insurance carriers, enabling us to expand our overall footprint in the benefits marketplace by aggregating many key constituents, including consumers, employers, and brokers. We believe our presence in both the employer and insurance carrier markets gives us a strong position at the center of the benefits ecosystem. As of December 31, 2014, we served over 23 million consumers on the Benefitfocus platform. As of December 31, 2014, we served 553 large employer customers, an increase from 121 in 2009, and 43 carrier customers, an increase from 28 in 2009.

We sell the Benefitfocus platform on a subscription basis, typically through annual contracts with our employer customers and multi-year contracts with our insurance carrier customers, with subscription fees paid monthly. The multi-year contracts with our carrier customers are generally only cancellable by the carrier in an instance of our uncured breach, although some of our carrier customers are able to terminate their respective contracts without cause or for convenience. Our software-as-a-service, or SaaS, model provides us visibility into our future operating results through increased revenue predictability, which enhances our ability to manage our business. Our company was founded in 2000, and we currently employ approximately 1,312 associates.

## **Industry Background**

The administration and distribution of benefits to employees is a mainstay of the U.S. economy. Providing these benefits is costly and complex and requires the exchange of information, application of rules, and transfer of funds among a wide variety of constituents, including consumers, employers, insurance carriers, brokers, benefits outsourcers, payroll processors, and financial institutions. According to IBISWorld calculations, in 2014, the market for HR benefits administration in the United States is expected to grow to over \$61 billion. In addition, Gartner estimates that in 2013, the U.S. insurance industry spent over \$58 billion on software and related services<sup>1</sup>.

The variety and complexity of core benefits plans, including healthcare, dental, life, and disability insurance continues to grow. In addition, employers are increasingly offering a range of voluntary benefits plans, such as critical illness, supplemental income, and wellness programs. The current system for providing benefits is changing rapidly and suffers from significant inefficiency as a result of complexity, regulation, and the involvement of multiple parties, leaving room for substantial improvement along the entire benefits value chain.

## ***Employer Market***

As of 2010, according to the United States Census Bureau, there were approximately 5.7 million employers in the United States. Currently, we believe there are over 18,000 entities that employ more than 1,000 individuals. A significant and growing portion of employers' costs is non-salary benefits, such as the health insurance that they provide to their employees. With healthcare and other premiums increasing, senior executives are prioritizing benefits administration in their organizations, searching for

<sup>1</sup> Gartner, *Forecast: Enterprise IT Spending by Vertical Industry Market, Worldwide, 2012-2018 1Q14 Update*, United States Insurance Market Spending on Software, IT Services, and Internal Services.

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ways to contain costs without sacrificing benefits. In addition, the expense burden continues to shift to employees. Employees' contributions to premiums for health insurance have grown from approximately \$318 in 1999 to approximately \$999 per employee in 2013. Employers recognize the importance of offering a greater variety of core and voluntary benefits as a means to attract, motivate, and retain employees. They must maintain relationships with multiple insurance carriers and many other benefits providers, placing a substantial administrative burden on their organizations.

Employers' distribution, management, and administration of employee benefits has historically consisted of error-prone, paper-based processes, and a patchwork of customized software tools, which are costly to maintain, often lack necessary functionality, and fail to address the increasing complexity of the benefits marketplace. As benefits offerings become more complex and employees bear more of the cost of those benefits, HR software solutions that streamline information, simplify choices, and engage employees are increasingly in demand. Employees desire tailored, dynamic, and interactive communication of critical benefits information as they become accustomed to receiving personalized content through various consumer applications on a range of devices.

Legacy HR systems were generally designed as extensions of enterprise resource planning, or ERP, systems, built for back-office responsibilities like finance and accounting. As a result, these systems lack functionality and ease-of-use for employees. Many legacy HR systems were not designed to integrate with the broader benefits ecosystem, including brokers, carriers, and wellness providers. This results in expensive, error-prone, and frustrating experiences for employers and employees. Benefits outsourcers have attempted to compensate for the shortcomings of legacy HR systems, but they have generally lacked adequate technology solutions necessary to keep up with the rapidly evolving benefits landscape. As a result, employees are often not provided with the appropriate functionality and information required to select and manage their benefits effectively.

Modern technology, changing communication patterns, and a constantly evolving benefits ecosystem have changed the employee-employer relationship. HR executives continue to search for effective strategies to increase efficiency and contain costs, while increasing employee engagement and satisfaction. Employers are increasingly interested in SaaS solutions that can help capture and analyze benefits data and ultimately lead to healthier, happier, and more productive employees. In order to manage the distribution and administration of benefits effectively, employers need an integrated platform, capable of handling all benefits in one place and providing a highly personalized experience for employees.

### ***Insurance Carrier Market***

The employee benefits market consists of a myriad of insurance carriers and products. According to the U.S. Bureau of Labor Statistics, the single largest benefit provided to employees in the United States is healthcare insurance, often encompassing more than 90% of all insurance benefits spending by employers. According to SNL Financial data, the U.S. private healthcare insurance market consists of approximately 357 carriers covering approximately 246 million individual consumers. Carriers provide benefits primarily through over 5.7 million U.S. employers.

Large, national insurance carriers also offer numerous individual health plans of different types, including health maintenance organizations, preferred provider organizations, point-of-service plans, and health savings accounts across the 50 states. Each carrier offers a complex variety of health insurance plans, with each plan requiring multiple decisions to address the specific needs of employers and their individual employees. Despite widespread carrier consolidation, numerous disparate systems remain in place, with many large carriers operating on multiple IT systems. Carriers often rely on manual processes and siloed software applications to bridge gaps in legacy administration systems. Even as carriers attempt to modernize and keep up with evolving industry practices and a changing regulatory landscape, they have difficulty connecting with the broader healthcare system.

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The effective delivery and management of healthcare benefits depends on the timely, continuous exchange of data among carriers, their employer customers, and individual members. Legacy benefits management systems often lack important functionality such as web and mobile self-service capabilities and real-time data exchange. Critical carrier processes, including member enrollment, billing, communications, and retail marketing have often been under-optimized or neglected by legacy systems, and carriers have devoted significant internal resources to cover technology gaps. In addition, healthcare reform mandates and the rise of exchanges have increased focus on carriers' retail distribution capabilities, which require additional investment.

Governmental oversight, punctuated with the passage of the Patient Protection and Affordable Care Act, or PPACA, has led to an increasingly intricate regulatory framework under which health benefits are delivered, accessed, and maintained. PPACA significantly expands insurance coverage through the individual mandate, with the goal of providing healthcare insurance to all U.S. citizens. To encourage enrollment, PPACA introduces a new distribution model in the form of healthcare exchanges—online marketplaces that allow insurance carriers to compete directly for new members. PPACA authorized the creation of publicly funded state exchanges in which individuals and small businesses can purchase health insurance directly from carriers. In addition to these federally mandated public exchanges, a number of private entities, including benefit outsourcers, carriers, and brokers are establishing their own private exchanges. We expect private exchanges will be less rigid, promoting both health and non-health benefits, with substantially fewer rules around the types of benefits offered. As insurance carriers continue to bolster their retail distribution capabilities, we believe they will require new technology solutions to attract additional members through private exchanges.

## **Reportable Segments**

Our reportable segments, Employer and Carrier, are based on type of customer. Financial information for Benefitfocus' reportable segments is included in Note 14 to our consolidated financial statements included in this Annual Report on Form 10-K.

## **The Benefitfocus Solutions**

We provide a multi-tenant cloud-based benefit platform to the employer and carrier markets. The Benefitfocus platform offers an integrated suite of software solutions that enables our customers to more efficiently shop, enroll, manage, and exchange benefits information.

We believe our solutions help employers in the following important ways:

*Simplify Benefits Enrollment.* Our solutions reduce the complexity of benefits enrollment by integrating all plan information in one place and presenting it to employees in an organized and easy-to-understand manner. Employees shop and enroll using a highly intuitive and engaging consumer-oriented interface. Side-by-side comparison tools and real-time quotes enable employees to understand and compare plans and determine how much each option will cost them every month. Notifications are sent in real-time when revised plan designs or new legislation affect coverage. We create videos and use avatars to give employees straightforward explanations of plan details, limitations, changes, and cost-sharing levels.

*Transition to Defined Contribution Benefits Funding Model.* Our solutions help enable employers' ongoing shift to defined contribution plans. Defined contribution plans differ from traditional defined benefit plans as they grant employees a stipend with which to purchase benefits of their choosing. Defined contribution plans also offer more discretion and options compared to defined benefit plans. Our products support traditional defined benefit plans, allowing employees to select from a list of benefits offered by their employer, calculating required member contributions, and recording



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and transmitting elections and other important information to payroll. Separately, with respect to defined contribution plans, our exchange solutions help facilitate an online shopping environment with many benefits options that allows employees to select personalized benefit offerings to suit their individual needs.

*Reduce Cost and Increase ROI.* Our solutions automate the benefits management process and reduce the cost associated with clerical errors and covering ineligible employees and dependents. They significantly reduce errors resulting from manual file creation, data entry, and sending enrollment materials via mail or fax. The Benefitfocus platform ensures plan information is more accurately captured and submitted in real-time. Automated audits and dependent verification functionality accurately ensure employers only pay benefits for eligible employees. Our solutions also include advanced analytics that enable employers and employees to quickly gather, report, and forecast benefit costs.

*Attract, Retain, and Motivate Employees.* Our solutions help employers attract, retain, and motivate top talent by delivering benefits information through a highly intuitive and engaging user interface. The Benefitfocus platform supports more than 100 types of plans and numerous third-party apps. Our solutions enable employees to have better visibility into the value of the plans available through their employers. Employees have a better understanding of their benefits and are empowered to make informed decisions. We believe that when employees understand the value of their benefits, they are more likely to be satisfied with and engaged in their jobs.

*Streamline HR Processes.* Our solutions eliminate the time-consuming and labor-intensive, often paper-based, processes associated with managing employee benefits plans, making HR professionals more efficient. Our solutions reduce the need to store paper forms and new hire enrollment packets, and provide one place to easily manage all benefits and related information. Employers and HR professionals can efficiently enroll users or update information, and communicate or make changes to plans in real-time. An intuitive user interface and a library of contextual online content explaining complex concepts and terms promote manager and employee self-service.

*Integrate Seamlessly with other Related Systems.* Our solutions can be easily and securely integrated with a variety of related systems, including carrier membership and billing systems, payroll and HR systems, banks, and other third-party administrators. We provide a network of over 900 benefit provider data exchange connections. Our solutions ensure accurate paycheck deductions and real-time enrollment in a variety of benefits plans. The Benefitfocus platform supports multiple data integration methods, including event-driven transactions, real-time web services, and XML or fixed-width file-based data exchange. In addition to convenient and flexible data exchange, the Benefitfocus platform also ensures that data is secure and accurate. Our open architecture further extends our functionality by allowing third parties to develop and offer apps and services on our platform.

We believe our solutions help insurance carriers in the following important ways:

*Attract and Maintain Membership.* Our solutions allow carriers to maximize sales capacity and efficiency by communicating directly with their employer customers and individual members. Carriers can track leads, generate quotes, create proposals with multiple products, and quickly follow-up with potential customers and members. The Benefitfocus platform also allows carriers to automate and integrate direct marketing, sales, underwriting, and enrollment to provide a high quality, efficient, and engaging online consumer shopping experience. Our solutions provide a library of customizable video content to deliver customized messages, reflect carrier branding, introduce new products, upsell ancillary consumer benefits, and enable consumers to navigate through complex healthcare processes to make informed decisions.

*Reduce Administrative Costs.* Our solutions improve the efficiency and effectiveness of the relationship between carriers and members. The Benefitfocus platform allows carriers to automate and

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simplify various aspects of the benefits administration process, such as enrollment, plan changes, eligibility updates, and billing, from one centralized location. Carriers can more easily apply complex business rules that enforce data accuracy and eliminate unnecessary costs such as coverage of ineligible employees. Members are able to view consolidated online invoices and pay electronically, eliminating the cost and inefficiencies inherent in paper-based billing and reducing time associated with bill payment and collection.

*Bolster Retail Distribution Capabilities Through Private Exchanges.* Our solutions help carriers respond to an evolving marketplace in which retail distribution capabilities are increasingly important to attracting and retaining new members. Our private exchange platform offers carriers a lower cost direct sales channel to employer groups and individuals. We offer the ability to sell both healthcare and non-healthcare benefit products in an online shopping environment that serves as an alternative to government-sponsored public exchanges.

*Facilitate Real-Time Data Exchange.* Our solutions simplify interactions and data exchange, and foster collaboration among carriers and their partners, brokers, employer customers, and individual members. This allows carriers to rapidly tailor and offer new benefits packages.

## **Our Growth Strategy**

We intend to strengthen our position as a leading provider of cloud-based benefits software solutions. Key elements of our growth strategy include the following:

*Expand our Customer Base.* We believe that our current customer base represents a small fraction of our targeted employers and carriers that could benefit from our solutions. While we served approximately 553 large employer customers as of December 31, 2014, we believe that there are over 18,000 large employers in the United States. We also served approximately 43 carrier customers as of December 31, 2014, but, according to SNL Financial data, the U.S. private healthcare insurance market alone consists of approximately 357 carriers. In order to reach new customers in our existing employer and carrier markets, we are aggressively investing in our sales and marketing resources and our channel marketing strategy.

*Deepen our Relationships with our Existing Customer Base.* We are deepening our employer relationships by continuing to provide a unified platform to manage increasingly complex benefits processes and simplify the distribution and administration of employee benefits. We are expanding our carrier relationships through both the upsell of additional software products and increased adoption across our carriers' member populations. We also believe our customers will use our benefits software solutions more if they are satisfied with our services. As we extend and strengthen the functionality of products, we plan to continue to invest in initiatives to increase the depth of adoption of our solutions and maintain our high levels of customer satisfaction.

*Extend our Suite of Applications and Continue our Technology Leadership.* We are extending the number, range, and functionality of our benefits applications. For example, we recently launched the new Benefitfocus Plan Shopping app, which allows employees to use actual claims data when comparing available benefits plans, helping them better understand the relationship among healthcare usage, available coverages options, and out-of-pocket costs. We have also extended the functionality of our products with various mobile applications. We intend to continue our collaboration with customers and partners, so we can respond quickly to evolving market needs with innovative applications and support our leadership position.

*Further Develop our Partner Ecosystem.* We have established strong relationships with organizations such as SuccessFactors, Allstate Insurance Company, Equifax, WageWorks, and others in a variety of industries to deliver best-in-class applications to our customers. Each of these partners

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brings additional functionality to the Benefitfocus platform, making it more attractive to customers. This in turn creates a broader audience and makes the Benefitfocus platform more attractive to potential partners. We believe that providing third-party applications to our network of employers, carriers, and consumers will help accelerate our growth, create revenue opportunities and deepen our relationships with existing customers. In support of these and other collaborations, we plan to continue to invest in our integration infrastructure to allow third parties and customers to build custom applications on the Benefitfocus platform and create deep integrations between their systems and ours.

We recently founded the Benefitfocus Implementation Program to train third-party system integrators such as Deloitte Consulting, LLP, ROC Americas, HRchitect, Providence Technology Solutions (affiliate of The HCiGroup) and Motion HR. This program should expand our ability to rapidly scale our service offerings while maintaining a high-quality customer experience. At the same time, it applies the system integrators broad experience across industries to support customers as they implement the Benefitfocus Platform.

*Leverage our Corporate Culture.* We believe our culture benefits our associates and customers and supports our growth. In 2014, we published Benefitfocus Winning With Culture 2 , which includes associates descriptions about our culture of collaboration, commitment, opportunity, and service, and describes the environment we created to encourage technology innovation. We plan to continue to invest in our culture to help attract and retain top design and engineering professionals that are passionate about Benefitfocus and motivated to create superior software technology. With loyal and engaged associates, we believe we can provide high levels of customer satisfaction, leading to greater sales of our benefits software solutions.

*Target New Markets.* We believe substantial demand for our solutions exists in markets and geographies beyond our current focus. We intend to leverage opportunities we believe will arise from the complexities of changing government regulation and increased enrollment impacting both Medicare and Medicaid. We also plan to grow our sales capability internationally by expanding our direct sales force and collaborating with strategic partners in new, international locations.

**The Benefitfocus Portfolio of Products**

Our portfolio of products, as summarized below, provides a seamless, integrated experience for the entire life cycle of benefits enrollment and management for insurance carriers and employers. We also provide extensive applications to help carriers and employers manage their programs more effectively.

**Products and Services for Insurance Carriers**

- eEnrollment
- eBilling
- eExchange
- eSales
- Marketplaces
- Benefit Informatics (now known as Data Cloud and Benefit Analytics)
- Implementation Services
- Media and Animation Services
- App Development Platform
- Software-Enabled Services
- BenefitStore

**Products and Services for Employers**

- HR InTouch Marketplace (now known as Benefitfocus Marketplace)
- Benefit Informatics (now known as the Data Cloud and Benefit Analytics)
- Implementation Services
- HR Support Center (now known as Benefits Service Center)
- Media and Animation Services
- App Development Platform
- Software-Enabled Services
- Benefitstore

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### **Products for Insurance Carriers**

*eEnrollment* is our flagship product for carriers, providing them with online enrollment for all types of benefits. We designed eEnrollment to enhance our users' experience by presenting information in a user-friendly format and integrating educational videos, and plan comparison and decision support tools to help navigate the enrollment process. In addition to helping customers find suitable plans, eEnrollment supports complex business rules, such as eligibility and rating criteria. eEnrollment facilitates the following activities:

*Initial Enrollment.* Employees and brokers can complete applications and health statements prior to making elections. Once the selection occurs, eEnrollment automatically calculates group numbers, finalizes benefit elections, and sends the data to the insurance carriers' membership systems.

*Open Enrollment.* eEnrollment simplifies open enrollment by providing tools to map employees from one plan to another, such as workflow, to-do lists, e-mail reminders, and a wide range of reports.

*New Hire Enrollment.* New hires can enroll in benefits anytime during their initial enrollment period. eEnrollment calculates wait periods and effective dates automatically to ensure compliance with the employers' business rules.

*Life Events.* Employees can make changes to their elections for specific reasons, including a birth, marriage, and military leave. eEnrollment calculates effective dates and helps employees understand what types of coverage changes are permitted with each type of life event.

*eBilling* is an electronic invoice presentment and payment solution, or EIPP. It consolidates invoices from multiple insurance products so employers and individuals receive one invoice that can be viewed and paid electronically. eBilling automates the synchronization of billing and membership data to improve the accuracy of billing processes and provides options to simplify bill payment, such as scheduled one-time and/or recurring payments.

*eExchange* is a solution that bridges the communication gap between carrier and employer systems, allowing a seamless exchange of data between the two. Our customers use eExchange to integrate data from multiple systems, convert data from one format to another, and manage the flow of employee data between carriers and employers.

*eSales* gives carriers and brokers tools to organize and proactively manage accounts, track leads, generate quotes, and create proposals for multiple products. eSales allows carriers to define their own market segments and configure them with unique workflows and business rules. It also enables greater data accuracy by automatically incorporating updated products, options and pricing for the most current rates and quotes. Carriers purchase eSales to increase productivity in their sales force.

*Marketplaces* are online shopping environments, sometimes referred to as exchanges, that allow customers to select from a variety of benefits plan choices to suit their individual needs. Marketplaces support the shift toward defined contribution benefits plans, which are increasing in popularity. Marketplaces provide consumer-centric experiences focused on personalization, and integrate social tools to help drive informed choices while selecting benefits. They also include features to track plans and compare pricing and features across multiple benefit plans.

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*Benefit Informatics (now known as Data Cloud and Benefits Analytics)* is our data analytics solution for use by carriers and their self-insured employer customers. Benefit Informatics is a privately-labeled analytics solution that helps carriers and their self-insured employers identify cost drivers, recognize trends, and predict future risks and costs. Additional analytical capabilities help create what-if scenarios to model different variables, such as co-pay, deductibles, benefits, inflation, and member populations.

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### ***Products for Employers***

*HR InTouch Marketplace (now known as Benefitfocus Marketplace)* is a cloud-based HR management portal that streamlines online enrollment, employee communication, and benefits administration, and creates a private exchange environment for large employers who offer defined contribution plans. In one cohesive, engaging workflow, HR InTouch Marketplace presents employees with all of the plans their employers offer. Employees who need extra assistance can access avatars, animated videos, and live chat sessions as they explore their benefit options. As employees shop for the plans that best fit their individual needs, a virtual shopping cart keeps a running tally of the employees' defined contribution in addition to the employees' out-of-pocket costs. If employees choose to purchase more coverage on their own, they can easily view and pay their bills in the HR InTouch Marketplace.

*Benefit Informatics (now known as Data Cloud and Benefits Analytics)* is our data analytics solution that helps employers make more informed, data-driven decisions about their benefits offerings. This product aggregates benefit cost and claims data from relevant sources and allows customers to analyze, forecast, and monitor costs. Benefit Informatics enables employers and their advisors to identify cost drivers, recognize trends, and predict future risks and costs. Additional analytical capabilities create what-if scenarios to model different variables, such as co-pays, deductibles, benefits, inflation, and member populations.

### ***Professional Services and Customer Support***

*Implementation Services.* We provide implementation services to our customers in order to help ensure seamless deployment and effective utilization of our solutions. Our carrier and employer implementation teams and third-party system integrators in our Benefitfocus Implementation Program follow a five-step approach for each implementation:

*Discovery*, including project planning and coordination to establish key milestones, documenting business and technical requirements, establishing a deployment strategy, and planning operational and market adoption activities.

*Configuration and deployment*, including configuring products to meet requirements identified during discovery, and defining needs for data exchange, payroll integration, and file transfer protocol.

*Integration*, including connecting the Benefitfocus platform functionality to a customer's currently existing systems, such as carrier membership and billing, payroll and HR systems, employee communications, intranets, and others.

*Testing*, including testing of various scenarios and uses cases, inbound and outbound payroll integration, and regression testing.

*Training and technical support*, including sessions to learn how to implement and access our products.

*HR Support Center (now known as Benefitfocus Service Center).* We provide employers with expanded support services where our benefits specialists help customers' employees understand benefit offerings, navigate the enrollment process, and find answers to frequently asked HR questions. Our HR Support Center provides employees with personalized, guided support. Additional services, such as fulfillment, dependent verification, and HR administration, are available to meet unique organizational needs.

*Media and Animation Services.* We create video and animated content that can be licensed within our applications or independently for distribution via client portals or websites. Benefitfocus provides a comprehensive video library and also can produce custom videos to meet specific communication requirements of its carrier and employer customers. Our staff of



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executive producers, project managers, writers, graphic designers, editors, and on-camera talent guide customers through the process from concept development to delivery. Benefitfocus hosts videos, eliminating the need for additional investments or internal IT resources by our customers. In addition, we incorporate our customers' unique branding to provide a seamless extension of corporate websites and messaging.

### ***Partner Offerings***

*App Development Platform.* We allow our partners and customers to develop custom apps that integrate directly with HR InTouch. HR professionals can easily work with external data and services through the same platform they are using to manage their benefits. Apps are organized into the following categories: voluntary benefits, health and wellness, benefits administration, finance, and communication. Representative apps include the RedBrick Health App, which provides access to customizable health assessments, digital coaching, tracking and challenges and the LifeLock App, which allows employees to purchase identity theft protection when they are enrolling in other benefit programs.

*Software-Enabled Services.* In addition to our app development platform, the open and flexible nature of our software architecture allows us to build deeper integrations with partner organizations and offer custom services in response to customer demand. Some examples include:

*SuccessFactors* provides employee performance management solutions. We partnered with them to create a full HR and benefits management suite that combines employee talent, profile, and core HR information to help drive employee onboarding, promotion, and development. The SuccessFactors suite of products provides an enterprise-class system of record, as well as powerful analytics and intuitive tools.

*WageWorks* supports benefits such as health savings accounts, flexible spending accounts, and health reimbursement programs, as well as commuter benefits, direct billing, and COBRA, through a single sign-on from our platform.

*Spectra Integration* provides print fulfillment services which enable customers to send employee information via mail to educate their workforce about benefit offerings, total compensation statements, and communication campaigns.

*BenefitStore* is a turn-key solution that makes available directly to employees a broad array of ancillary benefits like transit, supplemental life and disability, among others, to provide a more comprehensive and customizable benefits package.

### **Customers**

Our customers include employers of all sizes across a variety of industries and some of the nation's largest insurance carriers and aggregators. Following is a list of some of our significant employer and carrier customers.

#### **Employer Customers**

Amerigas Propane, Inc.  
Brooks Brothers Group, Inc.  
Cancer Treatment Centers of America  
Columbia Sportswear Company  
Fender Musical Instruments Corporation  
Rush University Medical Center  
Under Armour, Inc.

#### **Carrier Customers**

Aetna Life Insurance Company  
Allstate Insurance Company  
Anthem, Inc. (formerly Wellpoint, Inc.)  
Blue Cross and Blue Shield of Florida  
BlueCross and BlueShield of South Carolina  
Tufts Associated Health Plans, Inc.



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During the year ended December 31, 2014, no customer accounted for more than 10% of our total revenue.

### **Sales and Marketing**

We sell substantially all of our software solutions through our direct sales organization. Our direct sales team comprises employer-focused and carrier-focused field sales professionals who are organized primarily by geography and account size.

We generate customer leads, accelerate sales opportunities and build brand awareness through our marketing programs and strategic relationships. Our marketing programs target HR, benefits, and finance executives, technology professionals, and senior business leaders. Our principal marketing programs include:

use of our website to provide application and company information, as well as learning opportunities for potential customers;

territory development representatives who respond to incoming leads and convert them into new sales opportunities;

participation in, and sponsorship of, user conferences, executive events, trade shows and industry events, including our annual user and partner conference, One Place;

integrated marketing campaigns, including direct email, online web advertising, blogs and webinars; and

public relations, analyst relations and social media initiatives.

### **Technology Infrastructure and Operations**

As an enterprise cloud software vendor, we have always deployed our solutions using a SaaS model. Our customers access our software via the web or mobile devices, rather than by installing software on their premises. Through our multi-tenant platform, our customers access a single instance of our software with multiple possible configurations enabled by our metadata-driven framework. The multi-tenant approach provides significant operating leverage and improved efficiency as it helps us to reduce our fixed cost base and minimize unused capacity on our hardware. In addition, our software architecture gives us an advantage over vendors of legacy systems, who may be using a less flexible architecture that would require significant time and expense to update.

We host our applications and serve all of our customers from two redundant data centers in separate locations. We rely on third-party vendors to operate these data centers, which are designed to host mission-critical computer systems and have industry-standard measures in place to minimize service interruptions. Our technical operations staff manages the technology stacks supporting the Benefitfocus platform and uses automated monitoring tools throughout our system to detect unusual events or malfunctions that could interfere with our customers' or partners' use of the Benefitfocus platform. We monitor application health by verifying that all applications, interfaces and supporting middleware are operational. If our monitoring tools detect a problem, they notify our technical operations staff, who responds immediately to diagnose and resolve the problem. We take the security of our data and our systems very seriously, and we focus on minimizing the risk of vulnerabilities in our system at every level of software design and system and network administration.

### **Compliance and Certifications**

We obtain third-party examinations of our controls relating to security and data privacy. Certain examinations are conducted under Statement on Standards for Attestation Engagements, or SSAE, No. 16 (Reporting on Controls at a Service Organization). In particular, we obtain Service Organization

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Controls, or SOC, reports known as SOC 1 Type II and SOC 2 Type II audits that test the design and operating effectiveness of controls over a period of time. An independent auditor conducts these examinations annually and addresses, among other areas, our physical and environmental safeguards for production data centers, data availability and procedures covering integrity, change management, and logical security.

On an annual basis, we complete an internal audit of compliance against the Payment Card Industry Data Security Standards, or PCI-DSS, applicable to Level 1 service providers. These standards focus on application and network security controls for companies that transmit and store credit card data on behalf of clients. Benefitfocus meets PCI compliance requirements as a Level 1 service provider and submits its Report on Compliance and Attestation of Compliance documenting this assessment to the four major credit card brands annually.

In addition to PCI-DDS, Benefitfocus meets all applicable security requirements required by the National Automated Clearinghouse Association, or NACHA, for third-party service providers, as well as all requirements for Covered Entities as required by HIPAA. We validate both NACHA and HIPAA compliance annually through internal audits.

## **Competition**

While we do not believe any single competitor offers similarly expansive software solutions, we face competition from various sources, many of which have greater resources than us. Competition in our employer segment includes:

ERP software companies, including Oracle (PeopleSoft), Infor (Lawson) and Workday each offering a cloud-based benefits administration software solution;

HR outsourcing companies, including Aon/Hewitt and Towers Watson, both of which have recently launched benefits exchange solutions;

payroll service providers, including ADP and Paychex, both of which have expanded their core payroll services to include some form of cloud-based benefits administration services; and

various niche software vendors.

Competitors in our carrier segment include:

insurance carriers that have invested in internally developed benefit management solutions;

member services companies, including those providing web-based subscriber enrollment and claims adjudication services, such as Trizetto (acquired by Cognizant) and DST Health Solutions; and

various niche software vendors.

We believe that competition for benefits software and services is based primarily on the following factors:

capability for customization through configuration, integration, security, scalability, and reliability of applications;

competitive and understandable pricing;

breadth and depth of application functionality;

size of customer base and level of user adoption;

extensive data exchange network;

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cloud-based delivery model;

dynamic communication capabilities with contextual media, animation, and acknowledgement tools;

ability to integrate with legacy enterprise infrastructures and third-party applications;

domain expertise in benefits and healthcare consumerism;

extensive base of rules and event-driven benefit eligibility and enrollment;

accessible on any browser or mobile device;

modern and adaptive technology platform;

access to third-party apps;

clearly defined implementation timeline;

customer-branding and styling; and

ability to innovate and respond to customer and legislative needs rapidly.

We believe that we compete effectively based upon all of these criteria, and that we are likely to continue to retain a high percentage of our customers. Nonetheless, we believe that the increasing acceptance of automated solutions in the healthcare marketplace and the adoption of more sophisticated technology and legislative reform will result in increased competition, including potentially from large software companies with greater resources than ours. Other companies might develop superior or more economical service offerings that our customers could find more attractive than our offerings. Moreover, the regulatory landscape might shift in a direction that is more strategically advantageous to competitors.

## **Research and Development**

Our ability to compete depends, in large part, on our continuous commitment to rapidly introduce new applications, technologies, features, and functionality. We deliver multiple software releases per year, updating the Benefitfocus platform to leverage advances in cloud computing, mobile applications, and data management. Our research and development team is responsible for the design and development of our applications. We follow state-of-the-art practices in software development using modern programming languages, data storage systems, and other tools. We use both commercial and open source products, following a "best tool for the job" philosophy in product selection. Our software has a multi-tiered architecture that ensures flexibility to add or modify features quickly in response to changing market dynamics, customer needs, or regulatory requirements.

Our research and development expenses were \$41.7 million, \$23.5 million and \$14.6 million for the years ended December 31, 2014, 2013 and 2012, respectively.

## **Intellectual Property**

## Edgar Filing: Benefitfocus, Inc. - Form 10-K

We rely on a combination of patent, trade secret, copyright, and trademark laws, license agreements, confidentiality procedures, confidentiality and nondisclosure agreements, and technical measures to protect the intellectual property used in our business. We generally enter into confidentiality and nondisclosure agreements with our associates, consultants, vendors, and customers. We also seek to control access to and distribution of our software, documentation, and other proprietary information.

We use numerous trademarks for our products and services, and Benefitfocus , HR InTouch , HR InTouch Marketplace , All Your Benefits. One Place. , and Shop. Enroll. Manage. Exchange. are registered marks of Benefitfocus in the United States. Through claimed common law trademark

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protection, we also protect other Benefitfocus marks which identify our services, such as All Your Benefits. In Your Pocket. , Benefitfocus eEnrollment, Benefitfocus eBilling, Benefitfocus eExchange, and Benefitfocus eSales, and we have reserved numerous domain names, including benefitfocus.com . We also have registered trademarks and pending trademark applications in foreign jurisdictions such as Australia, Canada, India, Ireland, New Zealand, South Africa, and the United Kingdom.

We have been granted three U.S. patents (utility patents) and have eight U.S. patent applications (all for utility patents) pending. Our first patent, which protects specified systems and methods for the automatic creation of agent-based systems, was issued in April 2013 and will not expire until May 2030. Our second patent, which protects specified systems and methods for secure agent information, was issued in October 2013 and will not expire until November 19, 2030. Our third patent, which protects registration and execution of highly concurrent processing tasks, was issued in January 2015 and will not expire until February 2032. We also have one Chinese patent and 42 pending patent applications under foreign jurisdictions and treaties, such as Australia, Canada, China, Hong Kong, India, Japan, Taiwan, the European Patent Convention, and the Patent Cooperation Treaty.

We also rely on certain intellectual property rights that we license from third parties. Although we believe that alternative technologies are generally available to replace such licenses, these third-party technologies may not continue to be available to us on commercially reasonable terms.

Although we rely on intellectual property rights, including trade secrets, patents, copyrights, and trademarks, as well as contractual protections to establish and protect our proprietary 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.

The steps we have taken to protect our copyrights, trademarks, and other intellectual property may not be adequate, and the potential exists that third parties could infringe, misappropriate, or misuse our intellectual property. If this were to occur, it could harm our reputation and adversely affect our competitive position or operations. In addition, laws of other jurisdictions may not protect our intellectual property and proprietary rights from unauthorized use or disclosure in the same manner as the United States. The risk of unauthorized use of our proprietary and intellectual property rights may increase as our company expands outside of the United States.

## **Government Regulation**

### ***Introduction***

The employee benefits industry is required to comply with extensive and complex U.S. laws and regulations at the federal and state levels. Although many regulatory and governmental requirements do not directly apply to our business, our customers are required to comply with a variety of U.S. laws, and we may be impacted by these laws as a result of our contractual obligations. For many of these laws, there is little history of regulatory or judicial interpretation upon which to rely.

### ***Requirements of PPACA***

Our business could be affected by changes in healthcare spending. In March 2010, the President signed into law PPACA. As enacted, PPACA will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced Medicare program spending and insurance market reforms. By January 2014, PPACA required states to expand Medicaid coverage significantly and establish health insurance exchanges to facilitate the purchase of health insurance by individuals and small employers and provided subsidies to states to create non-Medicaid plans for certain low-income residents.

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Although numerous lawsuits challenged the constitutionality of PPACA, the U.S. Supreme Court on June 28, 2012, upheld the constitutionality of PPACA except for provisions that would have allowed the U.S. Department of Health and Human Services, or HHS, to penalize states that did not implement the Medicaid expansion with the loss of existing federal Medicaid funding. Consequently, a number of states opted out of the Medicaid expansion. Since that time, several states that initially opted out of the Medicaid expansion changed their minds and expanded Medicaid after all. While many of the provisions of PPACA will not be directly applicable to us, PPACA, as enacted, might affect the business of many of our customers. Carriers and large employers might experience changes in the numbers of individuals they insure as a result of Medicaid expansion and the creation of state and national exchanges, though it is unclear how many states will decline to implement the Medicaid expansion or adopt state-specific exchanges.

The long-term viability of PPACA is also currently in doubt. The House of Representatives has voted to repeal PPACA numerous times. Moreover, a lawsuit challenging the legality of the health insurance exchanges will likely be decided by the U.S. Supreme Court this summer. Should Congress repeal PPACA or the Supreme Court determine that government exchanges are unlawful, the business of our customers could be substantially affected.

### ***Requirements Regarding the Confidentiality, Privacy and Security of Personal Information***

***HIPAA and Other Privacy and Security Requirements.*** There are numerous U.S. federal and state laws and regulations related to the privacy and security of personal health information. In particular, regulations promulgated pursuant to the Health Insurance Portability and Accountability Act of 1996, or HIPAA, establish privacy and security standards that limit the use and disclosure of individually identifiable health information and require the implementation of administrative, physical and technological safeguards to ensure the confidentiality, integrity and availability of individually identifiable health information in electronic form. Health plans, healthcare clearinghouses and most providers are considered by the HIPAA regulations to be Covered Entities. With respect to our operations as a healthcare clearinghouse, we are directly subject to the Privacy Standards and the Security Standards. In addition, our carrier customers, or payors, are considered to be Covered Entities and are required to enter into written agreements with us, known as Business Associate Agreements, under which we are considered to be a Business Associate and that require us to safeguard individually identifiable health information and restrict how we may use and disclose such information. Effective February 2010, the American Recovery and Reinvestment Act of 2009, or ARRA, extended the direct application of some provisions of the Privacy Standards and Security Standards to us when we are functioning as a Business Associate of our Covered Entity customers. The Privacy Standards extensively regulate the use and disclosure of individually identifiable health information by Covered Entities and their Business Associates. For example, the Privacy Standards permit Covered Entities and their Business Associates to use and disclose individually identifiable health information for treatment and to process claims for payment, but other uses and disclosures, such as marketing communications, require written authorization from the individual or must meet an exception specified under the Privacy Standards. The Privacy Standards also provide patients with rights related to understanding and controlling how their health information is used and disclosed. Effective February 2010 or later (in the case of restrictions tied to the issuance of implementing regulations), ARRA imposed stricter limitations on certain types of uses and disclosures, such as additional restrictions on marketing communications and the sale of individually identifiable health information. To the extent permitted by the Privacy Standards, ARRA and our contracts with our customers, we may use and disclose individually identifiable health information to perform our services and for other limited purposes, such as creating de-identified information. Determining whether data has been sufficiently de-identified to comply with the Privacy Standards and our contractual obligations may require complex factual and statistical analyses and may be subject to interpretation. The Security Standards require Covered Entities and their Business Associates to implement and maintain administrative, physical and technical safeguards to protect the security of individually identifiable health information that is electronically transmitted or electronically stored.

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If we are unable to properly protect the privacy and security of health information entrusted to us, we could be found to have breached our contracts with our customers. Further, if we fail to comply with the Privacy Standards and Security Standards while acting as a Covered Entity or Business Associate, we could face civil and criminal penalties. ARRA significantly increased the amount of the civil penalties to up to \$50,000 per violation for a maximum civil penalty of \$1.5 million in a calendar year for violations of the same requirement. Recently, the U.S. Department of Health and Human Services Office for Civil Rights, which enforces the Security Standards and Privacy Standards, appears to have increased its enforcement activities. ARRA also strengthened the enforcement provisions of HIPAA, which may result in further increases in enforcement activity. ARRA also authorizes state attorneys general to bring civil actions seeking either injunctions or damages in response to violations of HIPAA privacy and security regulations that threaten the privacy of state residents. We have implemented and maintain policies and processes to assist us in complying with the Privacy Standards, the Security Standards and our contractual obligations.

*Data Protection and Breaches.* In recent years, there have been a number of well-publicized data breaches involving the improper dissemination of personal information of individuals. Many states have responded to these incidents by enacting laws requiring holders of personal information to maintain safeguards and to take certain actions in response to a data breach, such as providing prompt notification of the breach to affected individuals. In many cases, these laws are limited to electronic data, but states are increasingly enacting or considering stricter and broader requirements. Covered Entities must report breaches of unsecured protected health information to affected individuals without unreasonable delay, but not to exceed 60 days of discovery of the breach by a Covered Entity or its agents. Notification must also be made to HHS and, in certain circumstances involving large breaches, to the media. Business Associates must report breaches of unsecured protected health information to Covered Entities within 60 days of discovery of the breach by the Business Associate or its agents. The Federal Trade Commission, or FTC, has prosecuted some data breach cases as unfair and deceptive acts or practices under the Federal Trade Commission Act. Further, by regulation, the FTC requires creditors, which may include some of our customers, to implement identity theft prevention programs to detect, prevent and mitigate identity theft in connection with customer accounts. Although Congress passed legislation that restricts the definition of creditor and exempts many health providers from complying with this rule, we may be required to apply additional resources to our existing processes to assist our affected customers in complying with this rule. We have implemented and maintain physical, technical and administrative safeguards intended to protect all personal data and have processes in place to assist us in complying with all applicable laws and regulations regarding the protection of this data and properly responding to any security breaches or incidents.

*Other Requirements.* In addition to HIPAA, numerous other U.S. state and federal laws govern the collection, dissemination, use, access to and confidentiality of individually identifiable health information and healthcare provider information. Some states also are considering new laws and regulations that further protect the confidentiality, privacy and security of medical records or other types of medical information. In many cases, these state laws are not preempted by the Privacy Standards and may be subject to interpretation by various courts and other governmental authorities. Further, Congress and a number of states have considered or are considering prohibitions or limitations on the disclosure of medical or other information to individuals or entities located outside of the United States.

### ***HIPAA Administrative Simplification***

HIPAA also mandated a package of interlocking administrative simplification rules to establish standards and requirements for the electronic transmission of certain healthcare claims and payment transactions. These regulations are intended to encourage electronic commerce in the healthcare industry and apply directly to Covered Entities. Some of our businesses, including our healthcare clearinghouse operations, are considered Covered Entities under HIPAA and its implementing regulations.



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*Transaction Standards.* The standard transaction regulations established under HIPAA, or Transaction Standards, mandate certain format and data content standards for the most common electronic healthcare transactions, using technical standards promulgated by recognized standards publishing organizations. These transactions include healthcare claims, enrollment, payment and eligibility. The Transaction Standards are applicable to that portion of our business involving the processing of healthcare transactions among payors, providers, patients and other healthcare industry constituents. Failure to comply with the Transaction Standards may subject us to civil and potentially criminal penalties and breach of contract claims. The Centers for Medicare and Medicaid Services, or CMS, is responsible for enforcing the Transaction Standards.

Payors who are unable to exchange data in the required standard formats can achieve Transaction Standards compliance by contracting with a clearinghouse to translate between standard and non-standard formats. As a result, use of a clearinghouse has allowed numerous payors to establish compliance with the Transaction Standards independently and at different times, reducing transition costs and risks. In addition, the standardization of formats and data standards envisioned by the Transaction Standards has only partially occurred. However, PPACA requires HHS to establish operating rules to promote uniformity in the implementation of each standardized electronic transaction. PPACA sets forth a schedule with staggered deadlines for the development of and compliance with operating rules for the other standardized electronic transactions, with all operating rules finalized and requiring compliance by December 31, 2015. On June 30, 2011, HHS released an interim final rule that would require health plans, healthcare clearinghouses, and certain healthcare providers to implement operating rules for two electronic transactions, relating to whether a patient is eligible for healthcare coverage and the status of claims submitted to an insurer, by January 1, 2013. Under PPACA, payors and service contractors of payors, including, in some cases, us, will be required to certify compliance with these standards to HHS. The compliance date for the certification requirement depends on the type of transaction, with the earliest certification required by December 31, 2013. We cannot provide assurance regarding how the CMS will enforce the Transaction Standards. We continue to work with payors, healthcare information system vendors and other healthcare constituents to implement fully the Transaction Standards.

In January 2009, CMS published a final rule adopting updated standard code sets for diagnoses and procedures known as the ICD-10 code sets. A separate final rule also published by CMS in January 2009 resulted in changes to the formats to be used for electronic transactions, known as Version 5010. The use of Version 5010 became mandatory on January 1, 2012, but CMS delayed enforcement until July 1, 2012. The use of the ICD-10 code sets was originally required by October 1, 2013, but HHS extended this deadline twice, with the implementation date now set for October 1, 2015. It is not known whether HHS will further the delay implementation of the ICD-10 code sets. We have been modifying and will continue to modify our systems and processes to prepare for and implement these changes.

*Health Plan and Other Entity Identifiers.* HHS has promulgated regulations implementing the establishment of a unique health plan identifier, or HPID. Similar to a provider's national provider identifier, the HPID provides an identification system for health plans to use for electronic transactions. HHS has also promulgated regulations implementing another entity identifier, or OEID, that serves as an identifier for entities that are not health plans, health care providers or individuals. These other entities, which include third-party administrators, transaction vendors, and clearinghouses, are not required to obtain an OEID, but they could obtain and use one if they needed to be identified in standardized transactions. The impact of the HPID and OEID process on our business is unclear at this time.

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### ***Financial Services Related Laws and Rules***

Financial services and electronic payment processing services are subject to numerous laws, regulations and industry standards, some of which might impact our operations and subject us, our vendors and our customers to liability as a result of the payment distribution and processing solutions we offer. Although we do not act as a bank, we offer solutions that involve banks, or vendors who contract with banks and other regulated providers of financial services. As a result, we might be impacted by banking and financial services industry laws, regulations and industry standards, such as licensing requirements, solvency standards, requirements to maintain the privacy and security of nonpublic personal financial information and Federal Deposit Insurance Corporation deposit insurance limits. In addition, our patient billing and payment distribution and processing solutions might be impacted by payment card association operating rules, certification requirements and rules governing electronic funds transfers. If we fail to comply with applicable payment processing rules or requirements, we might be subject to fines and changes in transaction fees and may lose our ability to process credit and debit card transactions or facilitate other types of billing and payment solutions. Moreover, payment transactions processed using the Automated Clearing House Network, or ACH, are subject to network operating rules promulgated by the National Automated Clearing House Association and to various federal laws regarding such operations, including laws pertaining to electronic funds transfers, and these rules and laws might impact our billing and payment solutions. Further, our solutions might impact the ability of our payor customers to comply with state prompt payment laws. These laws require payors to pay healthcare claims meeting the statutory or regulatory definition of a *clean claim* to be paid within a specified time frame.

### **Banking Regulation**

The Goldman Sachs Group, affiliates of which owned approximately 33.3% of the voting and economic interest in our business as of December 31, 2014, is regulated as a bank holding company and a financial holding company under the Bank Holding Company Act of 1956, as amended, or the BHC Act. Due to the size of its voting and economic interest, we are deemed to be controlled by The Goldman Sachs Group and are therefore considered to be a *subsidiary* of The Goldman Sachs Group under the BHC Act. As a result, although we do not engage in banking operations, we are subject to regulation, supervision, examination and potential enforcement action by the Federal Reserve and to most banking laws, regulations and orders that apply to The Goldman Sachs Group. In addition, certain restrictions applicable to Goldman Sachs under the BHC Act are expected to apply to the Company as well, and we may be subject to regulatory oversight and examination because we are a technology service provider to regulated financial institutions. The bank regulatory framework is intended primarily to protect the safety and soundness of depository institutions, the federal deposit insurance system, and depositors rather than our stockholders. Because of The Goldman Sachs Group's status as a bank holding company, we have agreed to certain covenants for the benefit of The Goldman Sachs Group that are intended to facilitate its compliance with the BHC Act.

In addition, the Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, was signed into law by President Obama on July 21, 2010, including Title VI known as the *Volcker Rule*. US financial regulators approved final rules to implement the Volcker Rule in December 2013. The Volcker Rule, in relevant part, restricts banking entities from proprietary trading (subject to certain exemptions) and from acquiring or retaining any equity, partnership or other interests in, or sponsoring, a private equity fund, subject to satisfying certain conditions, and from engaging in certain transactions with funds.

We will continue to be deemed to be controlled by The Goldman Sachs Group for purposes of the BHC Act and, therefore, we will continue to be subject to regulation by the Federal Reserve and to the BHC Act, as well as certain other banking laws, regulations and orders that apply to The Goldman Sachs Group. We will remain subject to this regulatory regime until The Goldman Sachs Group is no

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longer deemed to control us for bank regulatory purposes, which we do not generally have the ability to control and which will not occur until The Goldman Sachs Group has significantly reduced its voting and economic interest in us. We cannot predict the ownership level at which the Federal Reserve would consider us no longer controlled by The Goldman Sachs Group, but it could be less than 10%.

The Goldman Sachs Group and its subsidiaries, including Benefitfocus, generally may conduct only activities that are authorized for a bank holding company or a financial holding company under the BHC Act. The scope of services we may provide to our customers is limited under the BHC Act to those which are (i) financial in nature or incidental to financial activities (including data processing services such as those that we provide with our software solutions) or (ii) complementary to a financial activity and which do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. We believe that our current and anticipated business activities are permitted under the BHC Act.

Any failure of The Goldman Sachs Group to maintain its status as a financial holding company could result in substantial limitations on our activities and our growth. In particular, our permissible activities could be further restricted to only those that constitute banking or activities closely related to banking. The Goldman Sachs Group's loss of its financial holding company status could be caused by several factors, including any failure by The Goldman Sachs Group's bank subsidiaries to remain sufficiently capitalized, by any examination downgrade of one of The Goldman Sachs Group's bank subsidiaries, or by any failure of one of The Goldman Sachs Group's bank subsidiaries to maintain a satisfactory rating under the Community Reinvestment Act. In addition, the Dodd-Frank Act broadened the requirements for maintaining financial holding company status by also requiring the holding company to remain well capitalized and well managed. We have no ability to prevent such occurrences from happening.

The Federal Reserve has broad enforcement authority over us, including the power to prohibit us from conducting any activity that, in the Federal Reserve's opinion, is unauthorized or constitutes an unsafe or unsound practice in conducting our business. The Federal Reserve may approve, deny or refuse to act upon applications or notices for The Goldman Sachs Group and its subsidiaries to conduct new activities, acquire or divest businesses or assets, or reconfigure existing operations. The Federal Reserve may also impose substantial fines and other penalties for violations of applicable banking laws, regulations and orders. The Dodd-Frank Act strengthened the Federal Reserve's supervisory and enforcement authority over a bank holding company's non-bank affiliates. We do not believe that any of our current or anticipated business activities will require Federal Reserve approval.

There are limits on the ability of The Goldman Sachs Group's bank subsidiaries to extend credit to or conduct other transactions with us. In general, any loans to us from a The Goldman Sachs Group bank subsidiary must be on market terms and secured by designated amounts of specified collateral and are limited to 10% of the lending bank's capital stock and surplus. Statutory changes made by the Dodd-Frank Act will place certain additional restrictions on transactions between us and The Goldman Sachs Group in the future, which we do not expect to be material to us.

## **Geographic Areas**

We operate solely in the United States. As such, we held substantially all our assets and generated all our revenue in the United States during the years ended December 31, 2014, 2013 and 2012.

## **Corporate Information**

We were incorporated in June 2000 as Benefitfocus.com, Inc., a South Carolina corporation. In September 2013, we reincorporated in Delaware as Benefitfocus, Inc. Our principal executive offices

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are located at 100 Benefitfocus Way, Charleston, South Carolina 29492, and our phone number is (843) 849-7476. Our website address is www.benefitfocus.com. The information on, or that can be accessed through, our website is not part of this report. We currently employ approximately 1,312 associates.

**Executive Officers**

The following table sets forth information concerning our executive officers as of December 31, 2014:

Name	Age	Position
Shawn A. Jenkins	47	President and Chief Executive Officer, Director
Mason R. Holland, Jr.	50	Executive Chairman, Director
Milton A. Alpern	63	Chief Financial Officer and Secretary
Raymond A. August	53	Chief Operating Officer
Andrew L. Howell	48	Chief Commercial Officer
Donald R. Taylor, Jr.	54	Chief Technology Officer
<i>Shawn A. Jenkins President, Chief Executive Officer, and Director</i>		

Shawn Jenkins, one of our founders, has been our President and Chief Executive Officer and a member of our board of directors since our founding in June 2000. Prior to founding Benefitfocus, from 1995 to 2000, he served as Vice President with American Pensions, Inc., leading sales, operations, and technology. From 1994 to 1995, Mr. Jenkins was a program analyst with Rockwell Automation, Inc. Mr. Jenkins serves on the Advisory Board for the School of Computing at Clemson University, Medical University of South Carolina Foundation Board of Directors, College of Charleston Board of Governors, and Charleston Southern University Board of Visitors. He previously served as Chairman of the Growing Forward Campaign for the Lowcountry Food Bank. Mr. Jenkins received an M.B.A. from Charleston Southern University and a B.A. from Geneva College in Beaver Falls, Pennsylvania.

*Mason R. Holland, Jr. Executive Chairman of the Board*

Mason Holland, one of our founders, has been our Executive Chairman and a member of our board of directors since our founding in June 2000. Mr. Holland is responsible for the coordination of strategic partnerships with industry leaders and client relations and serves on the nominating and corporate governance committee of our board. Mr. Holland founded American Pensions, Inc. in 1988, serving as its Chairman and President from 1988 to 2003. Mr. Holland's other ventures have included establishing Holland Properties, LLC, a real estate development firm, in 1989, and acquiring Eclipse Aerospace, Inc., a jet aircraft manufacturer, in May 2009, for which he serves as Chairman and Chief Executive Officer. Mr. Holland attended Old Dominion University in Norfolk, Virginia.

*Milton A. Alpern Chief Financial Officer*

Milt Alpern has served as our Chief Financial Officer since January 2012. Prior to joining Benefitfocus, from April 2008 to December 2011, he was the Chief Financial Officer for ITA Software, Inc., a SaaS provider of technology solutions to the travel industry, which was acquired by Google in 2011, where he was responsible for leading all financial and administrative functions for the company. Prior to ITA Software, from 2003 to 2008, Mr. Alpern served as the Chief Financial Officer for Applix, Inc., a publicly held international provider of business performance management and business intelligence software where he directed all finance, human resources, legal activities, and financial community relationships. From 1998 to 2002, Mr. Alpern served as the Chief Financial Officer at Eprise Corporation, a publicly held provider of business website content management software and solutions, where he was a member of the management team leading the company's successful initial public offering. Mr. Alpern holds a B.S. in accounting from Montclair State University.

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*Raymond A. August Chief Operating Officer*

Raymond August was appointed as our Chief Operating Officer in August of 2014. Prior to joining Benefitfocus, Mr. August served as the General Manager of the Computer Sciences Corp., or CSC, Financial Services Group since October 2012. Prior to that, from March 2008 to September 2012, he served as CSC's President of the Financial Services Group. Since July 2013 he has served as a member of the Executive Advisory council for Arthur Ventures Private Equity Fund. Mr. August earned a B.S. in Accounting and Management Science from the University of South Carolina and is a Certified Public Accountant.

*Andrew L. Howell Chief Commercial Officer*

Andy Howell has served as our Chief Commercial Officer since August of 2014. During his tenure at Benefitfocus, he previously served as our Chief Operating Officer from June 2010 to August 2014, Senior Vice President and General Manager of the insurance carrier business unit from June 2009 to June 2010, as well as Senior Vice President and General Counsel from April 2007 to June 2009. Prior to joining Benefitfocus, Mr. Howell served from July 2002 to March 2007 as Vice President and General Counsel at Blackbaud, Inc., a publicly held software company. Prior to joining Blackbaud, he was a practicing attorney with Sutherland Asbill & Brennan LLP, where he focused on corporate and technology law. Mr. Howell received a B.A. in economics from Washington & Lee University and a J.D. from Mercer University.

*Donald R. Taylor, Jr. Chief Technology Officer*

Don Taylor has served as our Chief Technology Officer since February 2008. As a software industry veteran of more than 25 years, Mr. Taylor brings expertise from his experience developing and providing advanced software solutions to the healthcare, banking, and logistics industries. Prior to joining Benefitfocus, from 2001 to 2006, Mr. Taylor was the founder and Chief Technology Officer of Boxcar Central, Inc., which developed a multi-tenant suite of SaaS applications for the third-party logistics market. Mr. Taylor received an A.S. from Charleston Southern University.

As of December 31, 2014, we had approximately 1,314 full-time associates, or employees, including approximately 576 engaged in technology development and deployment. None of our associates is represented by a labor union and we consider our current relations with our associates to be good.

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### ***Item 1A. RISK FACTORS.***

*Investing in our common stock involves a high degree of risk. You should consider carefully the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, including the consolidated financial statements and the related notes, before deciding to invest in shares of our common stock. If any of the following risks were to materialize, our business, financial condition, results of operations, and future growth prospects could be materially and adversely affected. In that event, the market price of our common stock could decline and you could lose part or all of your investment in our common stock.*

#### **Risks Related to Our Business**

***We have had a history of losses, and we might not be able to achieve or sustain profitability.***

We experienced net losses of \$63.2 million, \$30.4 million, and \$14.9 million for the years ended December 31, 2014, 2013, and 2012, respectively. We cannot predict if we will achieve sustained profitability in the near future or at all. We expect to make significant future expenditures to develop and expand our business. In addition, as a public company, we incur significant legal, accounting, and other expenses that we did not incur as a private company. These increased expenditures will make it harder for us to achieve and maintain future profitability. Our recent growth in revenue and number of customers might not be sustainable, and we might not achieve sufficient revenue to achieve or maintain profitability. We could incur significant losses in the future for a number of reasons, including the other risks described in this Annual Report on Form 10-K, and we may encounter unforeseen expenses, difficulties, complications and delays and other unknown events. Accordingly, we might not be able to achieve or maintain profitability and we may incur significant losses for the foreseeable future.

***Our quarterly operating results have fluctuated in the past and might continue to fluctuate, causing the value of our common stock to decline substantially.***

Our quarterly operating results might 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 might not be meaningful. You should not rely on our past results as indicative of our future performance. 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 the expectations of investors or securities analysts, the price of our common stock could decline substantially. For example, on March 7, 2014, the first trading day after we publically announced December 31, 2013 results and 2014 guidance, our stock price dropped almost \$5.00 per share, or 7.3%, to \$63.45.

Our operating results have varied in the past. 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 and services achieve or maintain market acceptance;

our ability to introduce new products and services and enhancements to our existing products and services on a timely basis;

new competitors and the introduction of enhanced products and services from competitors;

the financial condition of our current and potential customers;

changes in customer budgets and procurement policies;

the amount and timing of our investment in research and development activities;

technical difficulties with our products or interruptions in our services;

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our ability to hire and retain qualified personnel, including the rate of expansion of our sales force;

changes in the regulatory environment related to benefits and healthcare;

regulatory compliance costs;

the timing, size, and integration success of potential future acquisitions; and

unforeseen legal expenses, including litigation and settlement costs.

In addition, a significant portion of our operating expense is relatively fixed in nature, and planned expenditures are based in part on expectations regarding future revenue. Accordingly, unexpected revenue shortfalls might decrease our gross margins and could cause significant changes in our operating results from quarter to quarter. If this occurs, the trading price of our common stock could fall substantially, either suddenly or over time.

***As a result of our variable sales and implementation cycles, we might not be able to recognize revenue to offset expenditures, which could result in fluctuations in our quarterly results of operations or otherwise harm our future operating results.***

The sales cycle for our products and services can be variable, averaging four months in our employer market segment and 15 months in our carrier market segment, each from initial contact to contract execution. During the sales cycle, we expend time and resources, and we do not recognize any revenue to offset such expenditures.

After a customer contract is signed, we provide an implementation process for the customer during which we establish and test appropriate integrations, connections and registrations, load data into our system, and train customer personnel. Our implementation cycle is also variable, typically ranging from four to five months for employer implementations and from eight to 10 months for complex carrier implementations, each from contract execution to completion of implementation. Some of our new customer projects are complex and require a lengthy set-up period and significant implementation work. During the implementation cycle, we expend substantial time, effort, and financial resources implementing our products and services, but accounting principles do not allow us to recognize the resulting revenue until implementation is complete and the services are available for use, at which time we begin recognition of implementation revenue over the longer of the life of the contract or the expected life of the customer relationship. Each customer's situation is different, and unanticipated difficulties and delays might arise as a result of failure by us or by the customer to complete our respective responsibilities. If implementation periods are extended, revenue recognition could be delayed and our financial condition might be adversely affected. In addition, cancellation of any implementation after it has begun might result in lost time, effort, and expenses invested in the cancelled implementation process and lost opportunity for implementing paying clients in that same period of time.

These factors might contribute to continuing losses and substantial fluctuations in our quarterly operating results. As a result, in future quarters, our operating results could fall below the expectations of securities analysts or investors, in which event our stock price would likely decline.

***Because we recognize revenue and expense relating to monthly subscriptions and professional services over varying periods, downturns or upturns in sales are not immediately reflected in full in our operating results.***

As a SaaS company, we recognize our subscription revenue monthly for the term of our contracts and recognize the majority of our professional services revenue ratably over the longer of the contract term or the estimated expected life of the customer relationship. As a result, a portion of the revenue



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we report each quarter is the recognition of deferred revenue from contracts we entered into during previous quarters. Consequently, a shortfall in demand for our software solutions and professional services or a decline in new or renewed contracts in any one quarter might not significantly reduce our revenue for that quarter, but could negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in new or renewed sales of our products and services is not reflected in full in our results of operations until future periods. Our revenue recognition model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, because revenue from new customers must be recognized over the applicable term of the contracts or the estimated expected life of the customer relationship period. In addition, we recognize professional services expenses as incurred, which could cause professional services gross margin to be negative.

***We operate in a highly competitive industry, and if we are not able to compete effectively, our business and operating results will be harmed.***

The benefits management software market is highly competitive and is likely to attract increased competition, which could make it hard for us to succeed. Small, specialized providers continue to become more sophisticated and effective. In addition, large, well-financed, and technologically sophisticated software companies might focus more on our market. The size and financial strength of these entities is increasing as a result of continued consolidation in both the IT and healthcare industries. We expect large integrated software companies to become more active in our market, both through acquisitions and internal investment. As costs fall and technology improves, increased market saturation might change the competitive landscape in favor of our competitors.

Some of our current large competitors have greater name recognition, longer operating histories, and significantly greater resources than we do. As a result, our competitors might be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards, or customer requirements. In addition, current and potential competitors have established, and might in the future establish, cooperative relationships with vendors of complementary products, technologies, or services to increase the availability of their products in the marketplace. Accordingly, new competitors or alliances might emerge that have greater market share, a larger customer 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. Further, in light of these advantages, even if our products and services are more effective than those of our competitors, current or potential customers might accept competitive offerings in lieu of purchasing our offerings. Increased competition is likely to result in pricing pressures, which could negatively impact our sales, profitability, or market share. In addition to new niche vendors, who offer stand-alone products and services, we face competition from existing enterprise vendors, including those currently focused on software solutions that have information systems in place with potential customers in our target market. These existing enterprise vendors might promise products or services that offer ease of integration with existing systems and which leverage existing vendor relationships. In addition, large insurance carriers often have internal technology staffs and proprietary software for benefits management, making them less likely to buy our solutions.

***The market for our products and services is immature and volatile, and if it does not develop or if it develops more slowly than we expect, the growth of our business will be harmed.***

The cloud-based benefits management software market is relatively new and unproven, and it is uncertain whether it will achieve and sustain high levels of demand and market acceptance. Our success will depend to a substantial extent on the willingness of employers, carriers, and consumers to increase their use of benefits management software. Many employers and carriers have invested substantial personnel and financial resources to integrate internally developed solutions or traditional enterprise software into their businesses for benefits management, and therefore might be reluctant or

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unwilling to migrate to our cloud-based solutions. Furthermore, some businesses might be reluctant to use cloud-based solutions because they have concerns about the security of their data and the reliability of the technology delivery model associated with these solutions. If employers, carriers and consumers do not perceive the benefits of our solutions, then our market might not develop at all, or it might develop more slowly than we expect, either of which could significantly adversely affect our operating results. In addition, we have limited insight into trends that might develop and affect our business. We might make errors in predicting and reacting to relevant business trends, which could harm our business. If any of these risks occur, it could materially adversely affect our business, financial condition or results of operations.

***The SaaS pricing model is evolving and our failure to manage its evolution and demand could lead to lower than expected revenue and profit.***

We derive most of our revenue growth from subscription offerings and, specifically, SaaS offerings. This business model depends heavily on achieving economies of scale because the initial upfront investment is costly and the associated revenue is recognized on a ratable basis. If we fail to achieve appropriate economies of scale or if we fail to manage or anticipate the evolution and demand of the SaaS pricing model, then our business and operating results could be adversely affected.

***If we do not continue to innovate and provide products and services that are useful to consumers, employers, insurance carriers, and brokers and provide high quality support services, we might not remain competitive, and our revenue and operating results could suffer.***

Our success depends in part on providing products and services that consumers, employers, insurance carriers, and brokers will use to manage benefits. We must continue to invest significant resources in research and development in order to enhance our existing products and services and introduce new high quality products and services that customers 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, we might lose customers. Our operating results would also suffer if our innovations are not responsive to the needs of our customers, are not appropriately timed with market opportunity, or are not effectively brought to market. As technology continues to develop, our competitors might be able to offer results that are, or that are perceived to be, substantially similar to or better than those generated by us. This would force us to compete on additional product and service attributes and to expend significant resources in order to remain competitive.

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.

Our success also depends on providing high quality support services to resolve any issues related to our products and services. High quality education and customer support is important for the successful marketing and sale of our products and services and for the renewal of existing customers. If we do not help our customers quickly resolve issues and provide effective ongoing support, our ability to sell additional products and services to existing customers would suffer and our reputation with existing or potential customers would be harmed.

***If we are unable to retain our existing customers, our revenue and results of operations would be adversely affected.***

We sell our products and services pursuant to agreements that are generally one year for employers and three to five years for carriers. While our employer contracts generally automatically

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renew on an annual basis, our carrier customers have no obligation to renew their contracts after their contract period expires, and these contracts may not be renewed on the same or on more profitable terms if at all. Additionally, some of our carrier customers are able to terminate their respective contracts without cause or for convenience, although generally our carrier contracts are only cancellable by the carrier in an instance of our uncured breach. As a result, our ability to grow depends in part on the continuance and renewal of our carrier contracts. We may not be able to accurately predict future trends in customer renewals, and our customers' renewal rates may decline or fluctuate because of several factors, including their level of satisfaction or dissatisfaction with our services, the cost of our services, the cost of services offered by our competitors, or reductions in our customers' spending levels. If our carrier customers terminate or do not renew their contracts for our services, renew on less favorable terms, or do not purchase additional functionality or products, our revenue may grow more slowly than expected or decline, and our profitability and gross margins may be harmed.

***A significant amount of our revenue is derived from our largest customers, and any reduction in revenue from any of these customers would reduce our revenue and net income.***

Our ten largest customers by revenue in the past three years accounted for approximately 40.4%, 47.4% and 58.6% of our consolidated revenue in each of 2014, 2013 and 2012, respectively. Our largest customer by revenue in the past three years accounted for approximately 9.4%, 9.5% and 10.5% of our revenue in each of 2014, 2013 and 2012, respectively. If any of our large customers or strategic partners decides not to renew its contracts with us, or to renew on less favorable terms, our business, revenues, reputation, and our ability to obtain new customers could be materially and adversely affected.

***If the number of individuals covered by our employer and carrier customers decreases or the number of products or services to which our employer and carrier customers subscribe decreases, our revenue will decrease.***

Under most of our customer contracts, we base our fees on the number of individuals to whom our customers provide benefits and the number of products or services subscribed to by our customers. Many factors may lead to a decrease in the number of individuals covered by our customers and the number of products or services subscribed to by our customers, including:

failure of our customers to adopt or maintain effective business practices;

changes in the nature or operations of our customers;

government regulations; and

increased competition or other changes in the benefits marketplace.

If the number of individuals covered by our customers or the number of products or services subscribed to by our customers decreases for any reason, our revenue will likely decrease.

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

We have been experiencing a period of rapid growth, which puts strain on our business. To manage this and our anticipated future growth effectively, we must continue to maintain and enhance our IT infrastructure, financial and accounting systems, and controls. We also must attract, train, and retain a significant number of qualified sales and marketing personnel, customer support personnel, professional services personnel, software engineers, technical personnel, and management personnel. Failure to effectively manage our rapid growth could lead us to over-invest or under-invest in development and operations, result in weaknesses in our infrastructure, systems, or controls, give rise to operational mistakes, losses, loss of productivity or business opportunities, and result in loss of

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employees and reduced productivity of remaining employees. Our growth could require significant capital expenditures and might divert financial resources from other projects such as the development of new products and services. 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 quality of our products and services might suffer, which could negatively affect our reputation and harm our ability to retain and attract customers.

***Economic uncertainties or downturns in the general economy or the industries in which our customers operate could disproportionately affect the demand for our solutions and negatively impact our results of operations.***

General worldwide economic conditions have experienced a significant downturn, and market volatility and uncertainty remain widespread, making it extremely difficult for our customers and us to accurately forecast and plan future business activities. In addition, these conditions could cause our customers or prospective customers to decrease headcount, benefits, or HR budgets, which could decrease corporate spending on our products and services, resulting in delayed and lengthened sales cycles, a decrease in new customer acquisition, and/or loss of customers. Furthermore, during challenging economic times, our customers may have difficulty gaining timely access to sufficient credit or obtaining credit on reasonable terms, which could impair their ability to make timely payments to us and adversely affect our revenue. If that were to occur, our financial results could be harmed. Further, challenging economic conditions might impair the ability of our customers to pay for the products and services they already have purchased from us and, as a result, our write-offs of accounts receivable could increase. We cannot predict the timing, strength, or duration of any economic slowdown or recovery. If the condition of the general economy or markets in which we operate worsens, our business could be harmed.

***We depend on our senior management team, and the loss of one or more key associates or an inability to attract and retain highly skilled associates could adversely affect our business.***

Our success depends largely upon the continued services of our key executive officers. We also rely on our leadership team in the areas of research and development, marketing, services, and general and administrative functions, and on mission-critical individual contributors in research and development. 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. The loss of one or more of our executive officers or key associates could have a serious adverse effect on our business.

To continue to execute our growth strategy, we also must attract and retain highly skilled personnel. Competition is intense for engineers with high levels of experience in designing and developing software and Internet-related services. We might not be successful in maintaining our unique culture and continuing to attract and retain qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled personnel with appropriate qualifications. The pool of qualified personnel with SaaS experience and/or experience working with the benefits market is limited overall and specifically in Charleston, South Carolina, where our principal office is located. In addition, many of the companies with which we compete for experienced personnel have greater resources than we have and are located in geographic areas, like Silicon Valley, that may attract more qualified technology workers.

In addition, in making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the stock options they are to receive in connection with their employment. Volatility in the price of our stock might, therefore, adversely affect our ability to attract or retain highly skilled personnel. Furthermore, the requirement to expense stock

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options might discourage us from granting the size or type of stock option awards that job candidates require to join our company. 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.

*If we fail to maintain awareness of our brand cost-effectively, our business might suffer.*

We believe that maintaining awareness of our brand in a cost-effective manner is critical to continuing the widespread acceptance of our existing solutions and is an important element in attracting new customers. Furthermore, we believe that the importance of brand recognition will increase as competition in our market increases. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful services at competitive prices. Our efforts to build and maintain our brand nationally have involved significant expenses. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incur in maintaining our brand. If we fail to successfully maintain our brand, or incur substantial expenses in an unsuccessful attempt to maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

*Our growth depends in part on the success of our strategic relationships with third parties.*

In order to grow our business, we anticipate that we will continue to depend on our relationships with third parties, including Mercer LLC, or Mercer, and its affiliates and others such as technology and content providers, and third party system integrators. Identifying partners, and negotiating and documenting relationships with them, requires significant time and resources. Our recently expanded relationship with and sale of stock to Mercer increases our reliance on it and related risks, including Mercer's competitors being less likely to do business with us. Our competitors might be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our products and services. In addition, acquisitions of our partners by our competitors could result in a decrease in the number of our current and potential customers, as our partners may no longer facilitate the adoption of our applications by potential customers. If we are unsuccessful in establishing or maintaining our relationships with third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results may suffer. Even if we are successful, we cannot assure you that these relationships will result in increased customer use of our applications or increased revenue.

*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.*

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 the licensing of our software or sale of our services could result in substantial tax liabilities for past transactions and otherwise harm our business. For example, in the quarter ended September 30, 2014, New York gave us notice it is auditing us, and as a result we increased our sales tax reserve by \$0.3 million. 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, voluntarily engage state tax authorities in order to determine how to comply with their 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

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taxes in addition to taxes going forward. Liability for past taxes might also include substantial interest and penalty charges. Our customer contracts typically provide that our customers must pay all applicable sales and similar taxes. Nevertheless, our customers 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 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 software and services to our customers and might adversely affect our ability to retain existing customers or to gain new customers in the areas in which such taxes are imposed.

***We might not be able to utilize a significant portion of our net operating loss or other tax credit carryforwards, which could adversely affect our profitability.***

As of December 31, 2014, we had federal and state net operating loss carryforwards due to prior period losses, which if not utilized will begin to expire in 2022 for federal and state purposes. We also have South Carolina jobs tax credit and headquarters tax credit carryforwards, which if not utilized will begin to expire in 2020. These tax credit carryforwards could expire unused and be unavailable to offset future income tax liabilities, which could adversely affect our profitability.

In addition, under Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, our ability to utilize net operating loss carryforwards or other tax attributes in any taxable year may be limited if we experience an ownership change. A Section 382 ownership change generally occurs if one or more stockholders or groups of stockholders who own at least 5% of our stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules might apply under state tax laws. Future issuances of our stock could cause an ownership change. It is possible that an ownership change, or any future ownership change, could have a material effect on the use of our net operating loss carryforwards or other tax attributes, which could adversely affect our profitability.

***We might be unable to adequately protect, and we might incur significant costs in enforcing, our intellectual property and other proprietary rights.***

Our success depends in part on our ability to enforce our intellectual property and other proprietary rights. We rely on a combination of trademark, trade secret, copyright, patent, and unfair competition laws, as well as license and access agreements and other contractual provisions, to protect our intellectual property and other proprietary rights. In addition, we attempt to protect our intellectual property and proprietary information by requiring employees and consultants to enter into confidentiality, noncompetition, and assignment of inventions agreements. Our attempts to protect our intellectual property might be challenged by others or invalidated through administrative process or litigation. While we have three U.S. and one Chinese patent granted and a number of applications pending, we might not be able to obtain meaningful patent protection for our software. In addition, if any patents are issued in the future, they might not provide us with any competitive advantages, or might be successfully challenged by third parties. Agreement terms that address non-competition are difficult to enforce in many jurisdictions and might not be enforceable in certain cases. To the extent that our intellectual property and other proprietary rights are not adequately protected, third parties might gain access to our proprietary information, develop and market products or services similar to ours, or use trademarks similar to ours, each of which could materially harm our business. Existing U.S. federal and state intellectual property laws offer only limited protection. Moreover, the laws of other countries in which we might in the future conduct operations or contract for services might afford little or no effective protection of our intellectual property. The failure to adequately protect our intellectual property and other proprietary rights could materially harm our business.

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In addition, if we resort to legal proceedings to enforce our intellectual property rights or to determine the validity and scope of the intellectual property or other proprietary rights of others, the proceedings could be burdensome and expensive, even if we were to prevail. Any litigation that is necessary in the future could result in substantial costs and diversion of resources and could have a material adverse effect on our business, operating results or financial condition.

### ***We might be sued by third parties for alleged infringement of their proprietary rights.***

The software and Internet industries are characterized by the existence of a large number of patents, trademarks, and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past, and might receive in the future, communications from third parties claiming that we have infringed the intellectual property rights of others. Our technologies might not be able to withstand any third-party claims or rights against their use. Any intellectual property claims, with or without merit, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, and require us to pay monetary damages or enter into royalty or licensing agreements. In addition, many of our contracts contain warranties with respect to intellectual property rights, and most require us to indemnify our clients for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

Moreover, any settlement or adverse judgment resulting from such a claim could require us to pay substantial amounts of money or obtain a license to continue to use the software or information that is the subject of the claim, or otherwise restrict or prohibit our use of it. We might not be able to obtain a license on commercially reasonable terms, if at all, from third parties asserting an infringement claim; we might not be able to develop alternative technology on a timely basis, if at all; and we might not be able to obtain a license to use a suitable alternative technology to permit us to continue offering, and our clients to continue using, our affected services. Accordingly, an adverse determination could prevent us from offering our services to others.

### ***Failure to adequately expand our direct sales force will impede our growth.***

We believe that our future growth will depend on the continued development of our direct sales force and its ability to obtain new customers and to manage our existing customer base. Identifying and recruiting qualified personnel and training them in the use of our software requires significant time, expense, and attention. It can take six months or longer before a new sales representative is fully trained and productive. Our business may be adversely affected if our efforts to expand and train our direct sales force do not generate a corresponding increase in revenues. In particular, if we are unable to hire and develop sufficient numbers of productive direct sales personnel or if new direct sales personnel are unable to achieve desired productivity levels in a reasonable period of time, sales of our products and services will suffer and our growth will be impeded.

### ***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. 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 secured by us in the future could involve restrictive

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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, including potential acquisitions. 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.

*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 or employment claims made by our current or former associates. 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 reducing our operating results and leading analysts or potential investors to reduce their expectations of our performance, which could reduce the trading price of our stock.

*If we acquire companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value, and adversely affect our operating results and the value of our common stock.*

As part of our business strategy, we might acquire, enter into joint ventures with, or make investments in complementary companies, services, and technologies in the future. For example, in 2010, we acquired 100% of the net assets of Beninform Holdings, Inc., including its wholly owned subsidiary Benefit Informatics, Inc., and the intellectual property assets of BeliefNetworks, Inc. We spent considerable time, effort, and money pursuing these companies and successfully integrating them into our business. Acquisitions and investments involve numerous risks, including:

difficulties in identifying and acquiring products, technologies or businesses that will help our business;

difficulties in integrating operations, technologies, services and personnel;

diversion of financial and managerial resources from existing operations;

risk of entering new markets in which we have little to no experience; and

delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses. If we fail to properly evaluate acquisitions or investments, we might not achieve the anticipated benefits of any such acquisitions, we might incur costs in excess of what we anticipate, and management resources and attention might be diverted from other necessary or valuable activities.

*Future sales to customers outside the United States or with international operations might expose us to risks inherent in international sales which, if realized, could adversely affect our business.*

An element of our growth strategy is to expand internationally. Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic, and political risks that are different from those in the United States. Because of our limited experience with international operations, our international expansion efforts might not be successful in creating



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demand for our products and services outside of the United States or in effectively selling our solutions in the international markets we enter. In addition, we will face risks in doing business internationally that could adversely affect our business, including:

the need to localize and adapt our solutions for specific countries, including translation into foreign languages and associated expenses;

data privacy laws which require that customer data be stored and processed in a designated territory;

difficulties in staffing and managing foreign operations;

different pricing environments, longer sales cycles and longer accounts receivable payment cycles and collections issues;

new and different sources of competition;

weaker protection for intellectual property and other legal rights than in the United States and practical difficulties in enforcing intellectual property and other rights outside of the United States;

laws and business practices favoring local competitors;

compliance challenges related to the complexity of multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy, and data protection laws and regulations;

increased financial accounting and reporting burdens and complexities;

restrictions on the transfer of funds;

adverse tax consequences; and

unstable regional economic and political conditions.

If we denominate our international contracts in local currencies, fluctuations in the value of the U.S. dollar and foreign currencies might impact our operating results when translated into U.S. dollars.

### **Risks Related to Our Products and Services Offerings**

*If our security measures are breached or fail, and unauthorized persons gain access to customers and consumers data, our products and services might be perceived as not being secure, customers and consumers might curtail or stop using our products and services, and we might incur significant liabilities.*

## Edgar Filing: Benefitfocus, Inc. - Form 10-K

Our products and services involve the storage and transmission of customers' and consumers' confidential information, which may include sensitive individually identifiable information that is subject to stringent legal and regulatory obligations. Because of the sensitivity of this information, security features of our software are very important. If our security measures are breached or fail and/or are bypassed as a result of third-party action, employee error, malfeasance, or otherwise, someone might be able to obtain unauthorized access to our customers' confidential information and/or patient data. As a result, our reputation could be damaged, our business might suffer, information might be lost, and we could face damages for contract breach, penalties for violation of applicable laws or regulations, and significant costs for remediation and remediation efforts to prevent future occurrences.

In addition, we rely on various third parties, including employers' HR departments, carriers, and other third-party service providers and consumers themselves, as users of our system for key activities to protect and promote the security of our systems and the data and information accessible within them, such as administration of enrollment, consumer status changes, claims, and billing. On occasion,

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people have failed to perform these activities. For example, employers sometimes have failed to terminate the login/password of former employees, or permitted current employees to share login/passwords. When we become aware of such breaches, we work with employers to terminate inappropriate access and provide additional instruction in order to avoid the reoccurrence of such problems. Although to date these breaches have not resulted in claims against us or in material harm to our business, failures to perform these activities might result in claims against us, which could expose us to significant expense, legal liability, and harm to our reputation, which might result in loss of business.

Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we might not be able to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales and customers. Any significant violations of data privacy could result in the loss of business, litigation and regulatory investigations and penalties that could damage our reputation and adversely impact our results of operations and financial condition. In addition, our customers might authorize or enable third parties to access their information and data that is stored on our systems. Because we do not control such access, we cannot ensure the complete integrity or security of such data in our systems.

***Failure by our customers to obtain proper permissions and waivers might result in claims against us or may limit or prevent our use of data, which could harm our business.***

We require our customers to provide necessary notices and to obtain necessary permissions and waivers for use and disclosure of information on the Benefitfocus platform, and we require contractual assurances from them that they have done so and will do so. If, however, despite these requirements and contractual obligations, our customers do not obtain necessary permissions and waivers, then our use and disclosure of information that we receive from them or on their behalf might be limited or prohibited by state or federal privacy laws or other laws. This could impair our functions, processes and databases that reflect, contain, or are based upon such data and might prevent use of such data. In addition, this could interfere with, or prevent creation or use of, rules, analyses, or other data-driven activities that benefit us and our business. Moreover, we might be subject to claims or liability for use or disclosure of information by reason of lack of valid notices, agreements, permissions or waivers. These claims or liabilities could subject us to unexpected costs and adversely affect our operating results.

***Our proprietary 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.***

Proprietary 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 proprietary applications from operating properly. If they do not function reliably or fail to achieve customer expectations in terms of performance, customers could assert liability claims against us and/or attempt to cancel their contracts with us. This could damage our reputation and impair our ability to attract or maintain customers.

Moreover, benefits management software as complex as ours has in the past contained, and may in the future contain, or develop, undetected defects or errors. Material performance problems or defects in our products and services might arise in the future. Errors might result from the interface of our services with legacy systems and data, which we did not develop and the function of which is outside of our control. Defects or errors might arise in our existing or new software or service

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processes. Because changes in employer, carrier, and legal requirements and practices relating to benefits are frequent, we are continuously discovering defects and errors in our software and service processes compared against these requirements and practices. Undiscovered vulnerabilities could expose our software to unscrupulous third parties who develop and deploy software programs that could attack our software or result in unauthorized access to customer data. Defects and errors and any failure by us to identify and address them could result in loss of revenue or market share, liability to customers 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 customers from purchasing services 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.

In addition, customers that rely on our products and services to collect, manage, and report benefits data might have a greater sensitivity to service errors and security vulnerabilities than customers of software products in general. We market and sell services that, among other things, provide information to assist care providers in tracking and treating ill patients. Any operational delay in or failure of our software service processes might result in the disruption of patient care and could cause harm to our business and operating results.

Our customers 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 or 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.

### ***Various events could interrupt customers' access to the Benefitfocus platform, exposing us to significant costs.***

The ability to access the Benefitfocus platform is critical to our customers. Our operations and facilities are vulnerable to interruption and/or damage from a number of sources, many of which are beyond our control, including, without limitation: (i) power loss and telecommunications failures, (ii) fire, flood, hurricane, and other natural disasters, (iii) software and hardware errors, failures or crashes in our own systems or in other systems, (iv) computer viruses, denial-of-service attacks, hacking and similar disruptive problems in our own systems and in other systems, and (v) civil unrest, war, and/or terrorism. We have implemented various measures to protect against interruptions of customers' access to our platform. If customers' access is interrupted because of problems in the operation of our facilities, we could be exposed to significant claims by customers, particularly if the access interruption is associated with problems in the timely delivery of funds due to customers or medical information relevant to patient care. Our plans for disaster recovery and business continuity rely on third-party providers of related services. If those vendors fail us at a time when our systems are not operating correctly, we could incur a loss of revenue and liability for failure to fulfill our obligations. Any significant instances of system downtime could negatively affect our reputation and ability to retain customers and sell our services, which would adversely impact our revenue.

In addition, retention and availability of patient care and physician reimbursement data are subject to federal and state laws governing record retention, accuracy, and access. Some laws impose obligations on our customers and on us to produce information for third parties and to amend or expunge data at their direction. Our failure to meet these obligations might result in liability, which could increase our costs and reduce our operating results.

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*We rely on data center providers, Internet infrastructure, bandwidth providers, third-party computer hardware and software, other third parties, and our own systems for providing services to our customers, and any failure or interruption in the services provided by these third parties or our own systems could expose us to litigation and negatively impact our relationships with customers, adversely affecting our brand and our business.*

We serve all our customers from two data centers, one located in Raleigh, North Carolina and the other located in Charlotte, North Carolina. While we control and have access to our servers, we do not control the operation of these facilities. The owners of our data center facilities have no obligation 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 one of our data center operators is acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so. Problems faced by our third-party 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 customers, including us, could adversely affect the experience of our customers. Our third-party data centers operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy faced by our third-party data centers operators 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.

In addition, our ability to deliver our web-based services depends on the development and maintenance of the infrastructure of the Internet 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 in accordance with our service level commitments. 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 customers. To operate without interruption, both we and our service providers 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, including software from Oracle Corporation and Microsoft Corporation, and routers and network equipment from Cisco and Hewlett-Packard Company. These licenses 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.

We exercise limited control over third-party vendors, which increases our vulnerability to problems with technology and information services they provide. Interruptions in our network access and services might in connection with third-party technology and information services reduce our revenue, cause us to issue refunds to customers for prepaid and unused subscription services, subject

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us to potential liability, or adversely affect our renewal rates. Although we maintain insurance for our business, the coverage under our policies might not be adequate to compensate us for all losses that may occur. In addition, we might not be able to continue to obtain adequate insurance coverage at an acceptable cost, if at all.

### ***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.

## **Risks Related to Regulation**

### ***Government regulation of the areas in which we operate creates risks and challenges with respect to our compliance efforts and our business strategies.***

The employee benefits industry is highly regulated and is subject to changing political, legislative, regulatory, and other influences. Existing and new laws and regulations affecting the employee benefits industry could create unexpected liabilities for us, cause us to incur additional costs and restrict our operations. These laws and regulations are complex and their application to specific services and relationships are not clear. In particular, many existing laws and regulations affecting employee benefits, when enacted, did not anticipate the services that we provide, and these laws and regulations might be applied to our services in ways that we do not anticipate. Our failure to accurately anticipate the application of these laws and regulations, or our failure to comply, could create liability for us, result in adverse publicity, and negatively affect our business. Some of the risks we face from the regulation of employee benefits are as follows:

*PPACA.* Governmental oversight punctuated with the passage of the PPACA, has led to an increasingly intricate regulatory framework under which health benefits are delivered, accessed, and maintained. Although many of the provisions of PPACA do not directly apply to

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us, PPACA might affect the business of many of our customers. Carriers and large employers might experience changes in the numbers of individuals they insure as a result of Medicaid expansion and the creation of state and national exchanges, though it is unclear how many states will decline to implement the Medicaid expansion or adopt state-specific exchanges. Although we are unable to predict with any reasonable certainty or otherwise quantify the likely impact of PPACA on our business model, financial condition, or results of operations, changes in the business of our customers and the number of individuals they insure may negatively impact our business. Congress also has repeatedly but unsuccessfully attempted to repeal PPACA and we are unable to predict the impact. Moreover, a lawsuit challenging the legality of health insurance exchanges will likely be decided by the U.S. Supreme Court this summer. Should the U.S. Supreme Court determine that government exchanges are unlawful, the business of some of our customers could be substantially affected.

*False or Fraudulent Claim Laws.* There are numerous federal and state laws that forbid submission of false information or the failure to disclose information in connection with submission and payment of claims for reimbursement from the government. In some cases, these laws also forbid abuse of existing systems for such submission and payment. Although our business operations are generally not subject to these laws and regulations, any contract we have with a government entity requires us to comply with these laws and regulations. Any failure of our services to comply with these laws and regulations could result in substantial liability, including but not limited to criminal liability, could adversely affect demand for our services, and could force us to expend significant capital, research and development, and other resources to address the failure. Any determination by a court or regulatory agency that our services with government clients violate these laws and regulations could subject us to civil or criminal penalties, invalidate all or portions of some of our government client contracts, require us to change or terminate some portions of our business, require us to refund portions of our services fees, cause us to be disqualified from serving not only government clients but also all clients doing business with government payers, and have an adverse effect on our business.

*HIPAA and Other Privacy and Security Requirements.* There are numerous U.S. federal and state laws and regulations related to the privacy and security of personal health information. In particular, regulations promulgated pursuant to HIPAA established privacy and security standards that limit the use and disclosure of individually identifiable health information, and require the implementation of administrative, physical, and technological safeguards to ensure the confidentiality, integrity, and availability of individually identifiable health information in electronic form. Health plans, healthcare clearinghouses, and most providers are considered by the HIPAA regulations to be Covered Entities. With respect to our operations as a healthcare clearinghouse, we are directly subject to the privacy regulations established under HIPAA, or Privacy Standards, and the security regulations established under HIPAA, or Security Standards. In addition, our carrier customers, or payors, are considered to be Covered Entities and are required to enter into written agreements with us, known as Business Associate Agreements, under which we are considered to be a Business Associate and that require us to safeguard individually identifiable health information and restrict how we may use and disclose such information. ARRA and the HIPAA Omnibus Final Rules extended the direct application of certain provisions of the Privacy Standards and Security Standards to us when we are functioning as a Business Associate of our carrier customers. ARRA and the HIPAA Omnibus Final Rule also subject Business Associates to direct oversight and audit by HHS.

Violations of the Privacy Standards and Security Standards might result in civil and criminal penalties, and ARRA increased the penalties for HIPAA violations and strengthened the enforcement provisions of HIPAA. For example, ARRA authorizes state attorneys general to bring civil actions seeking either injunctions or damages in response to violations of Privacy Standards and Security Standards that threaten the privacy of state residents.

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We might not be able to adequately address the business risks created by HIPAA implementation. Furthermore, we are unable to predict what changes to HIPAA or other laws or regulations might be made in the future or how those changes could affect our business or the costs of compliance.

Some payors and clearinghouses interpret HIPAA transaction requirements differently than we do. Where payors or clearinghouses require conformity with their interpretations as a condition of a successful transaction, we seek to comply with their interpretations.

In addition to the Privacy Standards and Security Standards, most states have enacted patient confidentiality laws that protect against the disclosure of confidential medical and/or health information, and many states have adopted or are considering further legislation in this area, including privacy safeguards, security standards, and data security breach notification requirements. Such state laws, if more stringent than HIPAA requirements, are not preempted by the federal requirements and we are required to comply with them.

Failure by us to comply with any state standards regarding patient privacy may subject us to penalties, including civil monetary penalties and, in some circumstances, criminal penalties. Such failure may injure our reputation and adversely affect our ability to retain customers and attract new customers.

*Medicare and Medicaid Regulatory Requirements.* We have contracts with insurance carriers who offer Medicare Managed Care (also known as Medicare Advantage or Medicare Part C) and Medicaid Managed Care benefits plans. We also have contracts with insurance carriers who offer Medicare prescription drug benefits (also known as Medicare Part D) plans. The activities of the Medicare plans are regulated by the Centers for Medicare & Medicaid Services, or CMS, the federal agency that provides oversight of the Medicare and Medicaid programs. The Medicaid Managed Care plans are regulated by both CMS and the individual states where the plans are offered. Some of the activities that we might perform, such as the enrollment of beneficiaries, may be subject to CMS and/or state regulation, and such regulations may force us to change the way we do business or otherwise restrict our ability to provide services to such plans. Moreover, the regulatory environment with respect to these programs has become, and will likely continue to become, increasingly complex.

*Financial Services-Related Laws and Rules.* Financial services and electronic payment processing services are subject to numerous laws, regulations and industry standards, some of which might impact our operations and subject us, our vendors, and our customers to liability as a result of the payment distribution and processing solutions we offer. Although we do not act as a bank, we offer solutions that involve banks, or vendors who contract with banks and other regulated providers of financial services. As a result, we might be impacted by banking and financial services industry laws, regulations, and industry standards, such as licensing requirements, solvency standards, requirements to maintain the privacy and security of nonpublic personal financial information, and Federal Deposit Insurance Corporation deposit insurance limits. In addition, our patient billing and payment distribution and processing solutions might be impacted by payment card association operating rules, certification requirements, and rules governing electronic funds transfers. If we fail to comply with applicable payment processing rules or requirements, we might be subject to fines and changes in transaction fees and may lose our ability to process credit and debit card transactions or facilitate other types of billing and payment solutions. Moreover, payment transactions processed using the ACH are subject to network operating rules promulgated by the National Automated Clearing House Association and to various federal laws regarding such operations, including laws pertaining to electronic funds transfers, and these rules and laws might impact our billing and payment solutions. Further, our solutions might impact the ability of our payor customers to comply with state prompt payment laws. These laws require payors to pay healthcare claims meeting the statutory or regulatory definition of a "clean claim" within a specified time frame.



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*Insurance Broker Laws.* Insurance laws in the United States are often complex, and states have broad authority to adopt regulations regarding brokerage activities. These regulations typically include the licensing of insurance brokers and agents and govern the handling and investment of client funds held in a fiduciary capacity. Although we believe our activities do not currently constitute the provision of insurance brokerage services, regulations may change from state to state, which could require us to comply with such expanded regulation.

*ERISA.* The Employee Retirement Income Security Act of 1974, as amended, or ERISA, regulates how employee benefits are provided to or through certain types of employer-sponsored health benefits plans. ERISA is a set of laws and regulations that is subject to periodic interpretation by the U.S. Department of Labor as well as the federal courts. In some circumstances, and under certain customer contracts, we might be deemed to have assumed duties that make us an ERISA fiduciary, and thus be required to carry out our operations in a manner that complies with ERISA in all material respects. We believe that our current operations do not render us subject to ERISA fiduciary obligations, and therefore that we are in material compliance with ERISA and that any such compliance does not currently have a material adverse effect on our operations. However, there can be no assurance that continuing ERISA compliance efforts or any future changes to ERISA will not have a material adverse effect on us.

*Third-Party Administrator Laws.* Numerous states in which we do business have adopted regulations governing entities engaged in third-party administrator, or TPA, activities. TPA regulations typically impose requirements regarding enrollment into benefits plans, claims processing and payments, and the handling of customer funds. Although we do not believe we are currently acting as a TPA, changes in state regulations could result in us being obligated to comply with such regulations, which might require us to obtain licenses to provide TPA services in such states.

***We are subject to banking regulations that may limit our business activities.***

The Goldman Sachs Group, affiliates of which owned approximately 33.3% of the voting and economic interest in our business at December 31, 2014, is regulated as a bank holding company and a financial holding company under the BHC Act. The BHC Act imposes regulations and requirements on The Goldman Sachs Group and on any company that is deemed to be controlled by The Goldman Sachs Group under the BHC Act and the regulations of the Board of Governors of the Federal Reserve System, or the Federal Reserve. Due to the size of its voting and economic interest, we are deemed to be controlled by The Goldman Sachs Group and are therefore considered to be a subsidiary of The Goldman Sachs Group under the BHC Act. We will remain subject to this regulatory regime until The Goldman Sachs Group is no longer deemed to control us for purposes of the BHC Act, which we do not generally have the ability to control and which will not occur until The Goldman Sachs Group has significantly reduced its voting and economic interest in us.

As a controlled subsidiary of The Goldman Sachs Group, we are restricted from engaging in activities that are not permissible under the BHC Act, or the rules and regulations promulgated thereunder. Permitted activities for a bank holding company or any controlled subsidiary generally include activities that the Federal Reserve has previously determined to be closely related to banking, financial in nature or incidental or complementary to financial activities, including data processing services such as those that we provide with our software solutions. Restrictions placed on The Goldman Sachs Group as a result of supervisory or enforcement actions under the BHC Act or otherwise may restrict us or our activities in certain circumstances, even if these actions are unrelated to our conduct or business. Further, as a result of being subject to regulation and supervision by the Federal Reserve, we may be required to obtain the prior approval of the Federal Reserve before engaging in certain new activities or businesses, whether organically or by acquisition. The Federal

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Reserve could exercise its power to restrict us from engaging in any activity that, in the Federal Reserve's opinion, is unauthorized or constitutes an unsafe or unsound business practice. To the extent that these regulations impose limitations on our business, we could be at a competitive disadvantage because some of our competitors are not subject to these limitations.

Additionally, any failure of The Goldman Sachs Group to maintain its status as a financial holding company could result in further limitations on our activities and our growth. In particular, our permissible activities could be restricted to only those that constitute banking or activities closely related to banking. The Goldman Sachs Group's loss of its financial holding company status could be caused by several factors, including any failure by The Goldman Sachs Group's bank subsidiaries to remain sufficiently capitalized, by any examination downgrade of one of The Goldman Sachs Group's bank subsidiaries, or by any failure of one of The Goldman Sachs Group's bank subsidiaries to maintain a satisfactory rating under the Community Reinvestment Act. In addition, the Dodd-Frank Act broadened the requirements for maintaining financial holding company status by also requiring the holding company to remain "well capitalized" and "well managed." We have no ability to prevent such occurrences from happening.

As a subsidiary of a bank holding company, we are subject to examination by the Federal Reserve and required to provide information and reports for use by the Federal Reserve under the BHC Act. In addition, we may be subject to regulatory oversight and examination because we are a technology service provider to regulated financial institutions. The Federal Reserve may also impose substantial fines and other penalties for violations of applicable banking laws, regulations and orders. Further, the Dodd-Frank Act, including Title VI thereunder known as the

Volcker Rule, and related financial regulatory reform call for the issuance of numerous regulations designed to increase and strengthen the regulation of bank holding companies, including The Goldman Sachs Group and its affiliates. U.S. financial regulators approved the final rules to implement the Volcker Rule in December 2013. The Volcker Rule, in relevant part, restricts banking entities from proprietary trading (subject to certain exemptions) and from acquiring or retaining any equity, partnership or other interests in, or sponsoring, a private equity fund, subject to satisfying certain conditions, and from engaging in certain transactions with funds.

We have agreed to certain covenants for the benefit of The Goldman Sachs Group that are intended to facilitate its compliance with the BHC Act, but that may impose certain obligations on our company. In particular, The Goldman Sachs Group has rights to conduct audits on, and access certain information of, our company and certain rights to review the policies and procedures that we implement to comply with the laws and regulations that relate to our activities. In addition, we are obligated to provide The Goldman Sachs Group with notice of certain events and business activities and cooperate with The Goldman Sachs Group to mitigate potential adverse consequences resulting therefrom.

***Potential regulatory requirements placed on our software, services, and content could impose increased costs on us, delay or prevent our introduction of new service types, and impair the function or value of our existing service types.***

Our products and services are and are likely to continue to be subject to increasing regulatory requirements in a number of ways. As these requirements proliferate, we must change or adapt our products and services to comply. Changing regulatory requirements might render our services obsolete or might block us from accomplishing our work or from developing new 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 product or service types 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 unprofitable or impossible.

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### ***Potential government subsidy of services similar to ours, or creation of a single payor system, might reduce customer demand.***

Recently, entities including brokers and U.S. federal and state governments have offered to subsidize adoption of online benefits platforms or clearinghouses. In addition, federal regulations have been changed to permit such subsidy from additional sources subject to certain limitations. To the extent that we do not qualify or participate in such subsidy programs, demand for our services might be reduced, which may decrease our revenue. In addition, prior proposals regarding healthcare reform have included the concept of creation of a single payor for healthcare insurance. This kind of consolidation of critical benefits activity could negatively impact the demand for our services.

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

Among other things, certain services offered by us involve collecting payment information from individuals, and this frequently includes check and credit card information. Even though we do not handle direct payments, 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.

### **Risks Related to Ownership of Our Common Stock**

#### ***Our stock price may be volatile or may decline regardless of our operating performance, and you may not be able to resell your shares at or above the price at which you purchase it.***

The stock market historically has experienced extreme price and volume fluctuations. As a result of this volatility, you might not be able to sell your common stock at or above the price at which you purchase it. The public market for our stock is very new. From our IPO in September 2013 through December 31, 2014, the per share trading price of our common stock has been as high as \$77.00 and as low as \$20.82. It might continue to fluctuate significantly in response to various factors, some of which are beyond our control. These factors include:

our operating performance and the operating performance of similar companies;

the overall performance of the equity markets;

announcements by us or our competitors of acquisitions, business plans, or commercial relationships;

threatened or actual litigation;

changes in laws or regulations relating to the sale of health insurance;

any major change in our board of directors or 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;

large volumes of sales of our shares of common stock by existing stockholders; and

general political and economic conditions.

In addition, the stock market in general, and the market for Internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or

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disproportionate to the operating performance of those companies. These fluctuations might be even more pronounced in the relatively new trading market for our stock. Additionally, securities class action litigation has often been instituted against companies following 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 never declared or paid any cash dividends on our common stock and do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. 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.

***Our stock price could decline due to the large number of outstanding shares of our common stock eligible for future sale.***

Sales of a substantial number of shares of our common stock in the public market or the market perception that the holder or holders of a large number of shares intend to sell shares, could reduce the market price of our common stock. These sales could also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

As of December 31, 2014, we had an aggregate of 25,608,937 shares of common stock outstanding. Of these shares, approximately 15,649,749 shares became eligible for sale on October 14, 2014, upon the expiration of lock-up agreements with the underwriters for our secondary offering, subject in some cases to volume and other restrictions of Rule 144 under the Securities Act. As of December 31, 2014, there were outstanding options and restricted stock units to purchase 3,103,251 shares of our common stock that, if exercised or vested, as applicable, will result in these additional shares becoming available for sale subject in some cases to Rule 144. On November 12, 2013, we also registered an aggregate of 6,249,766 shares of our common stock that we may issue under our stock plans. These shares can be freely sold in the public market upon issuance, unless they are held by affiliates, as that term is defined in Rule 144 of the Securities Act. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

***A limited number of stockholders will have the ability to influence the outcome of director elections and other matters requiring stockholder approval.***

As of December 31, 2014, our directors, executive officers, and their affiliated entities beneficially owned more than 63% of our outstanding common stock. In particular, GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P., GS Capital Partners VI Fund, L.P., and GS Capital Partners VI GmbH & CO. KG, which are affiliates of Goldman, Sachs & Co. and which we refer to as the Goldman Funds, collectively beneficially owned approximately 33.3%. These stockholders, if they act together, could exert substantial influence over matters requiring approval by our stockholders, including the amendment of our certificate of incorporation and bylaws, and the approval of mergers or other business combination transactions.

Additionally, the Goldman Funds, Oak Investment Partners XII, L.P., Mason R. Holland, Jr., our Executive Chairman and a director, and Shawn A. Jenkins, our President and Chief Executive Officer and a director, entered into a voting agreement for the election of directors. As of December 31, 2014,

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these stockholders collectively beneficially owned more than 63% of our common stock. Pursuant to the voting agreement, the parties agree to vote all of their shares to elect two directors nominated by the Goldman Funds, one director nominated by Oak Investment Partners, and each of Messrs. Holland and Jenkins to our board of directors. As a result, these stockholders will have significant influence on the outcome of director elections. This concentration of ownership might discourage, delay, or prevent a change in control of our company, which could deprive our stockholders of an opportunity to receive a premium for their stock as part of a sale of our company and might reduce our stock price. These actions may be taken even if they are opposed by other stockholders.

***We are a controlled company within the meaning of the NASDAQ Stock Market listing rules, and take advantage of exemptions from certain corporate governance requirements.***

As of December 31, 2014, more than 63% of the voting power of our outstanding common stock was beneficially owned by a group of our significant stockholders consisting of Oak Investment Partners XII, L.P., the Goldman Funds, and Messrs. Holland and Jenkins. Under the NASDAQ Stock Market listing rules, a company of which more than 50% of the voting power is held by an individual, group or another company is a controlled company and is exempt from the corporate governance requirements that a majority of our directors be independent, as defined in the NASDAQ Stock Market listing rules, and that our compensation and nominating and corporate governance committees consist entirely of independent directors. We currently rely on the controlled company exemption under the NASDAQ Stock Market listing rules. While a majority of the members of our board of directors and all of the members of our compensation committee are independent directors, our nominating and corporate governance committee does not consist entirely of independent directors. Accordingly, while we remain a controlled company and during any transition period following a time when we are no longer a controlled company, you will not have the same protections afforded to stockholders of companies that are subject to all of the NASDAQ Stock Market's corporate governance requirements.

***Provisions in our restated certificate of incorporation and amended and restated bylaws and Delaware law might discourage, delay, or prevent a change in control of our company or changes in our management and, therefore, depress the trading price of our common stock.***

Provisions of our certificate of incorporation and bylaws and Delaware law might discourage, delay, or prevent a merger, acquisition, or other change in control that stockholders consider favorable, including transactions in which you might otherwise receive a premium for your shares of our common stock. These provisions might also prevent or frustrate attempts by our stockholders to replace or remove our management. These provisions include:

limitations on the removal of directors;

advance notice requirements for stockholder proposals and nominations;

limitations on the ability of stockholders to call special meetings;

The Goldman Sachs Group and its affiliates cease to own at least 35% of our voting equity, the inability of stockholders to act by written consent;

the inability of stockholders to cumulate votes at any election of directors;

the classification of our board of directors into three classes with only one class, representing approximately one-third of our directors, standing for election at each annual meeting; and

the ability of our board of directors to make, alter or repeal our bylaws.

Our Board of Directors has the ability to designate the terms of and issue new series of preferred stock without stockholder approval. In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly held Delaware corporation from engaging in a business combination

with an

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interested stockholder, generally a person which together with its affiliates owns, or within the last three years has owned, 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner.

The existence of the foregoing provisions and anti-takeover measures could limit the price that investors are willing to pay in the future for shares of our common stock. They could also deter potential acquirers of our company, thereby reducing the likelihood that you could receive a premium for your common stock in an acquisition.

***Our business is subject to changing regulations regarding corporate governance, disclosure controls, internal control over financial reporting, and other compliance areas that will increase both our costs and the risk of noncompliance.***

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, the Dodd-Frank Act, and the rules and regulations of our stock exchange. The requirements of these rules and regulations will increase our legal, accounting, and financial compliance costs, will make some activities more difficult, time-consuming, and costly, and may also place undue strain on our personnel, systems, and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. Commencing with our fiscal year ending December 31, 2014, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 of the Sarbanes-Oxley Act will require that we incur substantial accounting expense and expend significant management efforts. Prior to our IPO, we had never been required to test our internal controls within a specified period, and, as a result, we may experience difficulty in meeting these reporting requirements in a timely manner.

We are required to disclose changes made to our internal control and procedures on a quarterly basis. However, our independent registered public accounting firm will not be required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act until the later of the year following our first annual report required to be filed with the SEC or the date we are no longer an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, if we take advantage of the exemption available under the JOBS Act to the auditor attestation requirement in Section 404(b) of the Sarbanes-Oxley Act. If we are not able to comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner, the market price of our stock could decline and we could be subject to sanctions or investigations by the stock exchange on which our common stock is listed, the SEC, or other regulatory authorities, which would require additional financial and management resources.

***Failure to develop and maintain adequate financial controls could cause us to have material weaknesses, which could adversely affect our operations and financial position.***

As previously reported, in the first quarter of 2014, we identified a material weakness in internal controls over the accounting for leasing transactions which resulted in the identification of a material error in the accounting for our headquarters lease executed in May 2005. We might in the future discover other material weaknesses that require remediation. In addition, an internal control system, no matter how well-designed, cannot provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud will be detected. If we are not able to



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comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner, or if we are unable to maintain proper and effective internal controls, we might not be able to produce timely and accurate financial statements. If that were to happen, the market price of our stock could decline and we could be subject to sanctions or investigations by the stock exchange on which our common stock is listed, the SEC, or other regulatory authorities.

Any failure to develop or maintain effective controls, or any difficulties encountered in their implementation or improvement, could harm our operating results or cause us to fail to meet our reporting obligations. Any failure to implement and maintain effective internal controls also could adversely affect the results of periodic management evaluations regarding the effectiveness of our internal control over financial reporting that we are required to include in our periodic reports filed with the SEC under Section 404 of the Sarbanes-Oxley Act. Ineffective disclosure controls and procedures or internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers, and employees, entail substantial costs in order to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not be effective, however, in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In the event that we are not able to demonstrate compliance with Section 404 of the Sarbanes-Oxley Act in a timely manner, that our internal controls are perceived as inadequate, or that we are unable to produce timely or accurate financial statements, investors may lose confidence in our operating results and our stock price could decline.

***We are an emerging growth company and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.***

We are an emerging growth company. Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

For as long as we continue to be an emerging growth company, we intend to take advantage of certain other exemptions from various reporting requirements that are applicable to other public companies including, but not limited to, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved, and exemptions from the requirements of auditor attestation reports on the effectiveness of our internal control over financial reporting. We cannot predict if investors will find our common stock less attractive because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

We will remain an emerging growth company until the earliest of (i) the end of the fiscal year in which the market value of our common stock that is held by non-affiliates exceeds \$700 million as of June 30 of that fiscal year, (ii) the end of the fiscal year in which we have total annual gross revenue of \$1 billion or more during such fiscal year, (iii) the date on which we issue more than \$1 billion in non-convertible debt in a three-year period, or (iv) September 17, 2018.

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*If securities or industry analysts do not publish research or reports about our business, or publish inaccurate or unfavorable research or reports about our business, our stock price and trading volume could decline.*

The trading market for our common stock depends, to some extent, on the research and reports that securities or industry analysts publish about us and our business. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our common stock or change their opinion of our common stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

### ***Item 1B. Unresolved Staff Comments***

None.

### ***Item 2. Properties***

As of December 31, 2014, our corporate headquarters occupied approximately 65,000 square feet in a facility on the Daniel Island Executive Center campus in Charleston, South Carolina under a lease expiring in 2021, and we had a second facility on the Daniel Island Executive Center campus that occupied approximately 78,000 square feet under a lease expiring in 2024. As of December 31, 2014, we had also executed a lease that commenced January 1, 2015 and runs for 15 years, to extend our campus in Charleston, South Carolina with a Customer Success Center of approximately 145,000 square feet and, at our option and under new leases, have either a four-story office building of approximately 145,000 square feet and/or a two-story welcome center of approximately 18,500 square feet built.

As of December 31, 2014, we also leased facilities in Greenville, South Carolina, San Francisco, California, and Tulsa, Oklahoma.

We believe that our current and planned facilities are sufficient for our needs. We may add other facilities or expand existing facilities as we expand our associate base and geographic markets in the future, and we believe that suitable additional space will be available as needed to accommodate any such expansion of our operations.

### ***Item 3. Legal Proceedings***

From time to time, we might become involved in legal or regulatory proceedings arising in the ordinary course of our business. We are not currently a party to any material litigation or regulatory proceeding and we are not aware of any pending or threatened litigation or regulatory proceeding against us that could have a material adverse effect on our business, operating results, financial condition or cash flows.

### ***Item 4. Mine Safety Disclosures***

Not applicable.

**Table of Contents****PART II*****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities******Market Information for Common Stock***

Our common stock has been listed on the NASDAQ Global Market under the symbol "BNFT" since September 18, 2013. Prior to that date, there was no public trading market for our common stock. The following table sets forth for the periods indicated the high and low intraday sales prices per share of our common stock as reported on the NASDAQ Global Market.

	<b>High</b>	<b>Low</b>
<b>Year Ended December 31, 2013</b>		
Third quarter (from September 18, 2013)	\$ 55.87	\$ 41.50
Fourth quarter	\$ 60.48	\$ 37.32
<b>Year Ended December 31, 2014</b>		
First quarter	\$ 77.00	\$ 45.15
Second quarter	\$ 49.34	\$ 27.52
Third quarter	\$ 47.75	\$ 26.79
Fourth quarter	\$ 34.28	\$ 20.82

As of December 31, 2014, we had 84 holders of record of our common stock. The actual number of stockholders is greater than this number of record holders and includes stockholders who are beneficial owners but whose shares are held in street name by brokers and other nominees. This number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

***Dividend Policy***

We have never declared or paid any cash dividend on our common stock. We currently intend to retain all of our future earnings, if any, generated by our operations for the development and growth of our business for the foreseeable future. The decision to pay dividends is at the discretion of our board of directors and depends upon our financial condition, results of operations, capital requirements, and other factors that our board of directors deems relevant.

**Table of Contents*****Stock Performance Graph***

The following shall not be deemed filed for purposes of Section 18 of the Exchange Act, or incorporated by reference into any of our other filings under the Exchange Act or the Securities Act of 1933, as amended, except to the extent we specifically incorporate it by reference into such filing.

This chart compares the cumulative total return on our common stock with that of the S&P 500 Index and the S&P 1500 Application Software Index. The chart assumes \$100 was invested at the close of market on September 18, 2013, in the common stock of Benefitfocus, Inc., the S&P 500 Index and the S&P 1500 Application Software Index, and assumes the reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

Company / Index	Base						
	9/18/2013	9/30/2013	12/31/2013	3/31/2014	6/30/2014	9/30/2014	12/31/2014
Benefitfocus, Inc.	\$ 100.00	\$ 91.80	\$ 107.82	\$ 87.71	\$ 86.31	\$ 50.31	\$ 61.33
S&P 500 Index	\$ 100.00	\$ 97.45	\$ 107.12	\$ 108.51	\$ 113.60	\$ 114.30	\$ 119.32
S&P 1500 Application Software Index	\$ 100.00	\$ 99.07	\$ 107.46	\$ 107.29	\$ 112.30	\$ 113.71	\$ 120.00

***Equity Compensation Plans***

The information required by Item 5 of Form 10-K regarding equity compensation plans is incorporated herein by reference to Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .

***Use of Proceeds from Public Offering of Common Stock***

On September 17, 2013, our Registration Statement on Form S-1, (File No. 333-190610) was declared effective in connection with our IPO, pursuant to which 5,675,250 shares of common stock were registered, including the full exercise of the underwriters' over-allotment option. Of the shares registered, we sold 3,000,000 shares of common stock at a price to the public of \$26.50 per share for an aggregate price of \$79,500,000. Selling shareholders sold the remaining 2,675,250 shares registered at the same per share price for an aggregate price of \$70,894,000. The offering closed on September 23, 2013, and, as a result, we received net proceeds of \$70,064,000 (after underwriters' discounts and commissions of \$5,565,000 and additional offering related costs of \$3,871,000). The joint managing underwriters of the offering were Goldman Sachs & Co., Deutsche Bank Securities Inc. and Jefferies LLC.

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Of the expenses incurred by us in connection with our IPO, \$134,000 were paid to or for the underwriters and \$52,000 were paid to a related party vendor for private air travel. This vendor is owned and controlled by the Executive Chairman of our board of directors, who beneficially owns greater than 10% of our common stock.

There was no material change in the use of proceeds from our IPO as described in our final prospectus filed pursuant to Rule 424(b) of the Securities Act with the SEC on September 18, 2013. From the effective date of the registration statement through December 31, 2014, we have used the net proceeds from our IPO for working capital purposes and other general corporate purposes, including executing our growth strategy, developing new products and services, and funding additional capital expenditures, potential acquisitions, and investments. We have invested the funds received in short-term, interest bearing, investment-grade securities.

**Table of Contents****Item 6. Selected Financial Data****CONSOLIDATED SELECTED FINANCIAL DATA**

The following selected consolidated financial data for the years December 31, 2014, 2013, 2012, 2011, and 2010 and the selected consolidated balance sheet data as of December 31, 2014, 2013, 2012, 2011, and 2010 are derived from our audited consolidated financial statements. Our historical results are not necessarily indicative of the results to be expected in the future. The selected consolidated financial data should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements, related notes, and other financial information included elsewhere in this Annual Report on Form 10-K.

**Consolidated Statement of Operations Data**

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands, except share and per share data)				
Revenue (1)	\$ 137,420	\$ 104,752	\$ 81,739	\$ 68,783	\$ 67,122
Cost of revenue (2)	87,470	62,411	44,400	42,133	38,870
Gross profit	49,950	42,341	37,339	26,650	28,252
Operating expenses:					
Sales and marketing (2)	48,467	36,072	27,905	22,553	14,174
Research and development (2)	41,729	23,532	14,621	9,120	8,650
General and administrative (2)	18,657	10,974	7,494	5,821	6,038
Impairment of goodwill				1,670	
Change in fair value of contingent consideration		(43)	121	503	
Total operating expenses	108,853	70,535	50,141	39,667	28,862
Loss from operations	(58,903)	(28,194)	(12,802)	(13,017)	(610)
Total other expense, net	(4,251)	(2,198)	(1,987)	(2,012)	(1,855)
Loss before income taxes	(63,154)	(30,392)	(14,789)	(15,029)	(2,465)
Income tax expense (benefit)	25	(31)	84	35	10
Net loss	\$ (63,179)	\$ (30,361)	\$ (14,873)	\$ (15,064)	\$ (2,475)
Net loss per common share - basic and diluted	\$ (2.51)	\$ (2.99)	\$ (3.09)	\$ (3.09)	\$ (0.39)
Weighted-average common shares outstanding - basic and diluted	25,207,099	10,144,243	4,812,632	4,875,157	6,405,944
<b>Other Financial Data</b>					
Adjusted gross profit (3)	\$ 58,886	\$ 49,735	\$ 45,161	\$ 33,283	\$ 34,682
Adjusted EBITDA (4)	\$ (43,844)	\$ (18,915)	\$ (3,594)	\$ (3,455)	\$ 6,785

- (1) In the first quarter of 2011 we increased the estimated expected life of our customer relationships for both employer and carrier customers. This change extended the term over which we will recognize our deferred revenue and results in less revenue recognized in each period.

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- (2) Cost of revenue and operating expenses include stock-based compensation expense as follows:

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Cost of revenue	\$ 986	\$ 274	\$ 195	\$ 252	\$ 352
Sales and marketing	1,395	171	68	102	77
Research and development	1,376	255	130	121	87
General and administrative	1,831	502	319	246	519

- (3) We define adjusted gross profit as gross profit before depreciation and amortization expense, as well as stock-based compensation expense. Please see Adjusted Gross Profit and Adjusted EBITDA below for more information and for a reconciliation of adjusted gross profit to gross profit, the most directly comparable financial measure calculated and presented in accordance with GAAP.
- (4) We define adjusted EBITDA as net loss before net interest and other expense, taxes, and depreciation and amortization expense, adjusted to eliminate stock-based compensation expense and expense related to the impairment of goodwill and intangible assets. See Adjusted Gross Profit and Adjusted EBITDA below for more information and for a reconciliation of adjusted EBITDA to net loss, the most directly comparable financial measure calculated and presented in accordance with GAAP.

**Our Segments**

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Revenue from external customers by segment:					
Employer	\$ 62,016	\$ 40,656	\$ 23,760	\$ 15,938	\$ 9,356
Carrier	75,404	64,096	57,979	52,845	57,766
Total net revenue from external customers	\$ 137,420	\$ 104,752	\$ 81,739	\$ 68,783	\$ 67,122
Gross profit by segment					
Employer	\$ 16,186	\$ 13,316	\$ 9,810	\$ 6,059	\$ 3,121
Carrier	33,764	29,025	27,529	20,591	25,131
Total gross profit by segment	\$ 49,950	\$ 42,341	\$ 37,339	\$ 26,650	\$ 28,252

**Consolidated Balance Sheet Data**

	As of December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Cash and cash equivalents	\$ 51,074	\$ 65,645	\$ 19,703	\$ 15,856	\$ 18,166
Marketable securities	5,135	13,168			
Accounts receivable, net	21,311	23,668	13,372	9,060	7,163
Total assets	140,018	139,611	58,226	52,842	53,343
Deferred revenue, total	94,510	80,221	57,520	42,773	32,952
Total liabilities	182,841	128,179	89,357	69,809	55,433
Total redeemable convertible preferred stock			135,478	135,478	135,478
Common stock	26	24	6,109	4,923	3,574
Additional paid-in capital	223,409	214,487			

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Total stockholders' (deficit) equity	(42,823)	11,432	(166,609)	(152,445)	(137,569)
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***Adjusted Gross Profit and Adjusted EBITDA***

Within this prospectus we use adjusted gross profit and adjusted EBITDA to provide investors with additional information regarding our financial results. Adjusted gross profit and adjusted EBITDA are non-GAAP financial measures. We have provided below reconciliations of these measures to the most directly comparable GAAP financial measures, which for adjusted gross profit is gross profit, and for adjusted EBITDA is net loss.

We have included adjusted gross profit and adjusted EBITDA in this Annual Report on Form 10-K because they are key measures used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget, and to develop short- and long-term operational plans. In particular, we believe that the exclusion of the expenses eliminated in calculating adjusted gross profit and adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Accordingly, we believe that adjusted gross profit and adjusted EBITDA provide useful information to investors and others in understanding and evaluating our operating results.

Our use of adjusted gross profit and adjusted EBITDA as analytical tools has limitations, and you should not consider them in isolation or as substitutes for analysis of our financial results as reported under GAAP. Some of these limitations are:

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized might have to be replaced in the future, and adjusted gross profit and adjusted EBITDA do not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

adjusted gross profit and adjusted EBITDA do not reflect changes in, or cash requirements for, our working capital needs;

adjusted gross profit and adjusted EBITDA do not reflect the potentially dilutive impact of stock-based compensation;

adjusted gross profit and adjusted EBITDA do not reflect interest or tax payments that would reduce the cash available to us; and

other companies, including companies in our industry, might calculate adjusted gross profit and adjusted EBITDA or similarly titled measures differently, which reduces their usefulness as comparative measures.

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Because of these and other limitations, you should consider adjusted gross profit and adjusted EBITDA alongside other GAAP-based financial performance measures, including various cash flow metrics, gross profit, net income (loss) and our other GAAP financial results. The following table presents a reconciliation of adjusted gross profit to gross profit and adjusted EBITDA to net loss for each of the periods indicated:

	Year Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
<b>Reconciliation from Gross Profit to Adjusted Gross Profit:</b>					
Gross profit	\$ 49,950	\$ 42,341	\$ 37,339	\$ 26,650	\$ 28,252
Depreciation	5,459	4,257	4,228	4,096	4,272
Amortization of software development costs	2,257	2,618	3,145	2,009	1,690
Amortization of acquired intangible assets	234	245	254	276	116
Stock-based compensation expense	986	274	195	252	352
Adjusted gross profit	\$ 58,886	\$ 49,735	\$ 45,161	\$ 33,283	\$ 34,682
<b>Reconciliation from Net Loss to Adjusted EBITDA:</b>					
Net loss	\$ (63,179)	\$ (30,361)	\$ (14,873)	\$ (15,064)	\$ (2,475)
Depreciation	6,931	5,231	5,080	3,225	3,197
Amortization of software development costs	2,257	2,618	3,145	1,903	1,656
Amortization of acquired intangible assets	305	323	335	2,178	1,756
Interest income	(77)	(46)	(53)	(151)	(364)
Interest expense on building lease financing obligations	3,624	1,768	1,774	1,771	1,759
Interest expense on other borrowings	682	381	202	203	211
Income tax expense	25	(31)	84	35	10
Stock-based compensation expense	5,588	1,202	712	721	1,035
Impairment of goodwill and intangible assets				1,724	
Total net adjustments	\$ 19,335	\$ 11,446	\$ 11,279	\$ 11,609	\$ 9,260
Adjusted EBITDA	\$ (43,844)	\$ (18,915)	\$ (3,594)	\$ (3,455)	\$ 6,785

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis of our financial condition and results of operations together with our consolidated financial statements and the related notes and other financial information included elsewhere in this Annual Report on Form 10-K. Some of the information contained in this discussion and analysis or set forth elsewhere in this report including information with respect to our plans and strategy for our business, includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors section of this report beginning on page 23 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

**Overview**

We are a leading provider of cloud-based benefits software solutions for consumers, employers, insurance carriers, and brokers. The Benefitfocus platform provides an integrated suite of solutions that enables our employer and insurance carrier customers to more efficiently shop, enroll, manage, and exchange benefits information. Our web-based platform has a user-friendly interface designed to enable the insured consumers to access all of their benefits in one place. Our comprehensive solutions support core benefits plans, including healthcare, dental, life, and disability insurance, and voluntary benefits plans, such as critical illness, supplemental income, and wellness programs. As the number of employer benefits plans has increased, with each plan subject to many different business rules and requirements, demand for the Benefitfocus platform has grown.

We serve two separate but related market segments. Our fastest growing market segment, the employer market, consists of employers offering benefits to their employees. Within this segment, we mainly target large employers with more than 1,000 employees, of which we believe there are approximately 18,000 in the United States. In our other market segment, we sell our solutions to insurance carriers, enabling us to expand our overall footprint in the benefits marketplace by aggregating many key constituents, including consumers, employers, and brokers. Our business model capitalizes on the close relationship between carriers and their members, and the carriers' ability to serve as lead generators for potential employer customers. Carriers pay for services at a rate reflective of the aggregated nature of their customer base on a per application basis. Carriers can then deploy their applications to employer groups and members. As employers become direct customers through our employer segment, we provide them our platform offering that bundles many software applications into a comprehensive benefits solution through HR InTouch Marketplace (now known as Benefitfocus Marketplace). We believe our presence in both the employer and insurance carrier markets gives us a strong position at the center of the benefits ecosystem.

We sell our software solutions and related services primarily through our direct sales force. We derive most of our revenue from software services fees, which primarily consist of monthly subscription fees paid to us for access to and usage of our cloud-based benefits software solutions, and related professional services. Software services fees paid to us from our employer customers are generally based on the number of employees covered by the relevant benefits plans at contracted rates for a specified period of time, which is usually one year. Software services fees paid to us from our carrier customers are based on the number of members contracted to use our solutions at contracted rates for a specified period of time, which usually ranges from three to five years. Our carrier contracts are

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generally only cancellable by the carrier in an instance of our uncured breach, although some of our carrier customers are able to terminate their respective contracts without cause or for convenience. Software services revenue accounted for approximately 91%, 93%, and 93% of our total revenue during the years ended December 31, 2014, 2013 and 2012, respectively.

Another component of our revenue is professional services. We derive the majority of our professional services revenue from the implementation of our customers onto our platform, which typically includes discovery, configuration and deployment, integration, testing, and training. In general, it takes from four to five months to implement a new employer customer's benefits systems and eight to 10 months to implement a new carrier customer's benefits systems. We also provide customer support services and customized media content that supports our customers' effort to educate and communicate with consumers. Professional services revenue accounted for approximately 9%, 7%, and 7% of our total revenue during the years ended December 31, 2014, 2013 and 2012, respectively.

Increasing our base of large employer customers is an important source of revenue growth for us. We actively pursue new employer customers in the U.S. market, and we have increased the number of large employer customers utilizing our solutions from 121 as of December 31, 2009 to 553 as of December 31, 2014, a 35.5% compound annual growth rate. We believe that our continued innovation and new solutions, such as online benefits marketplaces, also known as private exchanges, enhanced mobile offerings, and more robust data analytics capabilities will help us attract additional large employer customers and increase our revenue from existing customers.

We believe that there is a substantial market for our services, and we have been investing in growth over the past four years. In particular, we have continued to invest in technology and services to better serve our larger employer customers, which we believe are an important source of growth for our business. We have also substantially increased our marketing and sales efforts and expect those increased efforts to continue. As we have invested in growth, we have had operating losses in each of the last four years, and expect our operating losses to continue for the foreseeable future. Due to the nature of our customer relationships, which have been very stable with relatively few customer losses over the past years, and the subscription nature of our financial model, we believe that our current investment in growth should lead to substantially increased revenue, which will allow us to achieve profitability in the relatively near future. Of course, our ability to achieve profitability will continue to be subject to many factors beyond our control.

## **Key Financial and Operating Performance Metrics**

We regularly monitor a number of financial and operating metrics in order to measure our current performance and project our future performance. These metrics help us develop and refine our growth strategies and make strategic decisions. We discuss revenue, gross margin, and the components of operating loss, as well as segment revenue and segment gross profit, in Management's Discussion and Analysis of Financial Condition and Results of Operations - Components of Operating Results. In addition, we utilize other key metrics as described below.

**Table of Contents*****Number of Large Employer and Carrier Customers***

We believe the number of large employer and carrier customers is a key indicator of our market penetration, growth, and future revenue. We have aggressively invested in and intend to continue to invest in our direct sales force to grow our customer base. We generally define a customer as an entity with an active software services contract as of the measurement date. The following table sets forth the number of large employer and carrier customers for the periods indicated:

	Year Ended December 31,		
	2014	2013	2012
Number of customers:			
Large employer	553	393	286
Carrier	43	40	34

***Software Services Revenue Retention Rate***

We believe that our ability to retain our customers and expand the revenue they generate for us over time is an important component of our growth strategy and reflects the long-term value of our customer relationships. We measure our performance on this basis using a metric we refer to as our software services revenue retention rate. We calculate this metric for a particular period by establishing the group of our customers that had active contracts for a given period. We then calculate our software services revenue retention rate by taking the amount of software services revenue we recognized for this group in the subsequent comparable period (for which we are reporting the rate) and dividing it by the software services revenue we recognized for the group in the prior period.

For 2014, 2013 and 2012 our software services revenue retention rate exceeded 95%.

***Adjusted Gross Profit and Adjusted EBITDA***

Adjusted gross profit represents our gross profit before depreciation and amortization, as well as stock-based compensation expense. Adjusted EBITDA represents our earnings before net interest and other expense, taxes, and depreciation and amortization expense, adjusted to eliminate stock-based compensation and impairment of goodwill and intangible assets. Adjusted gross profit and adjusted EBITDA are not measures calculated in accordance with United States generally accepted accounting principles, or GAAP. Please refer to Selected Consolidated Financial Data Adjusted Gross Profit and Adjusted EBITDA in this report for a discussion of the limitations of adjusted gross profit and adjusted EBITDA and reconciliations of adjusted gross profit to gross profit and adjusted EBITDA to net loss, the most comparable GAAP measurements, respectively, for 2014, 2013 and 2012.

**Components of Operating Results*****Revenue***

We derive the majority of our revenue from software services fees, which consist primarily of monthly subscription fees paid to us by our employer and carrier customers for access to, and usage of, our cloud-based benefits software solutions for a specified contract term. We also derive revenue from professional services fees, which primarily include fees related to the implementation of our customers onto our platform. Our professional services typically include discovery, configuration and deployment, integration, testing, and training.

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The following table sets forth a breakdown of our revenue between software services and professional services for the periods indicated (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Software services	\$ 125,083	\$ 97,713	\$ 75,931
Professional services	12,337	7,039	5,808
<b>Total revenue</b>	<b>\$ 137,420</b>	<b>\$ 104,752</b>	<b>\$ 81,739</b>

We generally recognize software services fees monthly based on the number of employees covered by the relevant benefits plans at contracted rates for a specified period of time, provided that an enforceable contract has been signed by both parties, access to our software has been granted to the customer and is available for their use, the fee for the software services is fixed or determinable, and collection is reasonably assured. We defer recognition of our professional services fees paid by customers in connection with implementation of our software services, or implementation fees, and recognize them, beginning once the software services have commenced, ratably over the longer of the contract term or the estimated expected life of the customer relationship. We will periodically evaluate the term over which revenue is recognized for most professional services as we gain more experience with customer contract renewals.

We generally invoice our employer and carrier customers for software services in advance, in monthly installments. We invoice our employer customers for implementation fees at the inception of the arrangement. We generally invoice our carrier customers for implementation fees at various contractually defined times throughout the implementation process. Implementation fees that have been invoiced are initially recorded as deferred revenue until recognized as described above.

***Overhead Allocation***

Expenses associated with our facilities, IT costs, and depreciation and amortization, are allocated between cost of revenue and operating expenses based on employee headcount determined by the nature of work performed.

***Cost of Revenue***

Cost of revenue primarily consists of salaries and other personnel-related costs, including benefits, bonuses, and stock-based compensation, for associates providing services to our customers and supporting our SaaS platform infrastructure. Additional expenses in cost of revenue include co-location facility costs for our data centers, depreciation expense for computer equipment directly associated with generating revenue, infrastructure maintenance costs, amortization expenses associated with capitalized software development costs, allocated overhead, and other direct costs.

Our cost of revenue is expensed as we incur the costs. However, the related revenue from fees we receive for our implementation services performed before a customer is operating on our platform is deferred until the commencement of the monthly subscription and recognized as revenue ratably over the longer of the related contract term or the estimated expected life of the customer relationship. Therefore, the cost incurred in providing these services is expensed in periods prior to the recognition of the corresponding revenue. Our cost associated with providing implementation services has been significantly higher as a percentage of revenue than our cost associated with providing our monthly subscription services due to the labor associated with providing implementation services.

We plan to continue to expand our capacity to support our growth, which will result in higher cost of revenue in absolute dollars. However, we expect cost of revenue as a percentage of revenue to

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decline and gross margins to increase primarily from the growth of the percentage of our revenue from large employers and the realization of economies of scale driven by retention of our customer base.

### ***Operating Expenses***

Operating expenses consist of sales and marketing, research and development, and general and administrative expenses. Salaries and personnel-related costs are the most significant component of each of these expense categories. We expect to continue to hire new associates in these areas in order to support our anticipated revenue growth. As a result, we expect our operating expenses to increase in both aggregate dollars and as a percentage of revenue in the near term, but to decrease over the longer term as we achieve economies of scale.

*Sales and marketing expense.* Sales and marketing expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, stock-based compensation, and commissions for our sales and marketing associates. We record expense for commissions at the time of contract signing. Additional expenses include advertising, lead generation, promotional event programs, corporate communications, travel, and allocated overhead. For instance, our most significant promotional event is One Place, which we have held annually in the second quarter and in 2015 will hold in the first quarter. We expect our sales and marketing expense to increase in both absolute dollars and as a percentage of revenue in the foreseeable future as we further increase the number of our sales and marketing professionals and expand our marketing activities in order to continue to grow our business.

*Research and development expense.* Research and development expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, and stock-based compensation for our research and development associates. Additional expenses include costs related to the development, quality assurance, and testing of new technology, and enhancement of our existing platform technology, consulting, travel, and allocated overhead. We believe continuing to invest in research and development efforts is essential to maintaining our competitive position. We expect our research and development expense to increase in absolute dollars and as a percentage of revenue for the near term, but decrease as a percentage of revenue over the longer term as we achieve economies of scale.

*General and administrative expense.* General and administrative expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, and stock-based compensation for administrative, finance and accounting, information systems, legal, and human resource associates. Additional expenses include consulting and professional fees, insurance and other corporate expenses, and travel. We expect our general and administrative expenses to increase in absolute terms as a result of operating as a public company and will include costs associated with compliance with the Sarbanes-Oxley Act and other regulations governing public companies, increased costs of directors and officers liability insurance, increased professional services expenses, and costs associated with an enhanced investor relations function.

### ***Other Income and Expense***

Other income and expense consists primarily of interest income and expense, accretion of contingent consideration, and gain (loss) on disposal of fixed assets. Interest income represents interest received on our cash and cash equivalents. Interest expense consists primarily of the interest incurred on outstanding borrowings under our financing obligations, existing notes and credit facilities.

### ***Income Tax Expense***

Income tax expense consists of U.S. federal and state income taxes. We incurred minimal income tax expense for 2014, 2013, and 2012. Net operating loss carryforwards for federal income tax

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purposes were \$68,235 million at December 31, 2014. State net operating loss carryforwards were approximately \$61,583 million at December 31, 2014. Federal net operating loss carryforwards will expire at various dates beginning in 2022, if not utilized. State net operating losses will expire at various dates beginning in 2022, if not utilized. Valuation allowances are recorded to reduce deferred tax assets to the amount we believe is more likely than not to be realized.

**Results of Operations****Consolidated Statements of Operations Data**

The following table sets forth our consolidated statements of operations data for each of the periods indicated (in thousands).

	Year Ended December 31,		
	2014	2013	2012
Revenue	\$ 137,420	\$ 104,752	\$ 81,739
Cost of revenue (1)	87,470	62,411	44,400
Gross profit	49,950	42,341	37,339
Operating expenses:			
Sales and marketing (1)	48,467	36,072	27,905
Research and development (1)	41,729	23,532	14,621
General and administrative (1)	18,657	10,974	7,494
Change in fair value of contingent consideration		(43)	121
Total operating expenses	108,853	70,535	50,141
Loss from operations	(58,903)	(28,194)	(12,802)
Other income (expense):			
Interest income	77	46	53
Interest expense on building lease financing obligations	(3,624)	(1,768)	(1,774)
Interest expense on other borrowings	(682)	(381)	(202)
Other expense	(22)	(95)	(64)
Total other expense, net	(4,251)	(2,198)	(1,987)
Loss before income taxes	(63,154)	(30,392)	(14,789)
Income tax expense (benefit)	25	(31)	84
Net loss	\$ (63,179)	\$ (30,361)	\$ (14,873)

(1) Cost of revenue and operating expenses include stock-based compensation expense as follows (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Cost of revenue	\$ 986	\$ 274	\$ 195
Sales and marketing	1,395	171	68
Research and development	1,376	255	130
General and administrative	1,831	502	319



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

	Year Ended December 31,		
	2014	2013	2012
Revenue	100.0%	100.0%	100.0%
Cost of revenue	63.7	59.6	54.3
Gross profit	36.3	40.4	45.7
Operating expenses:			
Sales and marketing	35.3	34.4	34.1
Research and development	30.4	22.5	17.9
General and administrative	13.6	10.5	9.2
Change in fair value of contingent consideration			0.1
Total operating expenses	79.2	67.3	61.3
Loss from operations	(42.9)	(26.9)	(15.7)
Other income (expense):			
Interest income	0.1		0.1
Interest expense on building lease financing obligations	(2.6)	(1.7)	(2.2)
Interest expense on other borrowings	(0.5)	(0.4)	(0.2)
Other expense		(0.1)	(0.1)
Total other expense, net	(3.1)	(2.1)	(2.4)
Loss before income taxes	(46.0)	(29.0)	(18.1)
Income tax expense (benefit)			0.1
Net loss	(46.0)%	(29.0)%	(18.2)%

**Our Segments**

The following table sets forth segment results for revenue and gross profit for the periods indicated (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Revenue from external customers by segment:			
Employer	\$ 62,016	\$ 40,656	\$ 23,760
Carrier	75,404	64,096	57,979
Total net revenue from external customers	\$ 137,420	\$ 104,752	\$ 81,739
Gross profit by segment			
Employer	\$ 16,186	\$ 13,316	\$ 9,810
Carrier	33,764	29,025	27,529
Total gross profit by segment	\$ 49,950	\$ 42,341	\$ 37,339



**Table of Contents****Comparison of Years Ended December 31, 2014 and 2013****Revenue**

	Year Ended December 31, 2014		2013		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Software services	\$ 125,083	91.0%	\$ 97,713	93.3%	\$ 27,370	28.0%
Professional services	12,337	9.0	7,039	6.7	5,298	75.3
<b>Total revenue</b>	<b>\$ 137,420</b>	<b>100.0%</b>	<b>\$ 104,752</b>	<b>100.0%</b>	<b>\$ 32,668</b>	<b>31.2%</b>

Growth in software services revenue was primarily attributable to the addition of new customers, as the number of large employer and carrier customers increased to 596 as of December 31, 2014 from 433 as of December 31, 2013. Our professional services revenue increased in absolute terms between the year ended December 31, 2013 and the year ended December 31, 2014, primarily due to revenue recognized from newly completed implementations of \$3.2 million in addition to \$2.1 million from the acceleration of the customer relationship period for customers that did not renew their contracts.

**Segment Revenue**

	Year Ended December 31, 2014		2013		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Employer	\$ 62,016	45.1%	\$ 40,656	38.8%	\$ 21,360	52.5%
Carrier	75,404	54.9	64,096	61.2	11,308	17.6
<b>Total revenue</b>	<b>\$ 137,420</b>	<b>100.0%</b>	<b>\$ 104,752</b>	<b>100.0%</b>	<b>\$ 32,668</b>	<b>31.2%</b>

The growth in our employer revenue was primarily attributable to a \$20.0 million increase in our employer software services revenue driven primarily by an increase in the number of large employer customers using our platform as of December 31, 2014 as compared to December 31, 2013. Additionally, employer professional services contributed an increase of \$1.4 million primarily related to newly completed implementations.

The growth in our carrier revenue was primarily attributable to an increase of \$7.3 million in our carrier software services revenue driven primarily by an increase in software services revenue from recent customer product implementations during the year ended December 31, 2014 as compared to the year ended December 31, 2013. The remaining increase of \$4.0 million is related to carrier professional services and is comprised of an increase of \$1.9 million in revenue related to customers who went live on the platform and \$2.1 million related to the acceleration of the customer relationship period for customers that did not renew their contracts.

**Cost of Revenue**

	Year Ended December 31, 2014		2013		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Cost of revenue	\$ 87,470	63.7%	\$ 62,411	59.6%	\$ 25,059	40.2%



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The increase in cost of revenue was in part attributable to an \$18.6 million increase in salaries and personnel-related costs and professional fees, including an increase of \$0.7 million related to stock-based compensation, of which \$16.0 million was associated with increased client service capacity to support our growing number of customers and an increase in engineering costs of \$1.2 million. Also, we experienced a \$6.4 million increase in infrastructure maintenance costs to support our platform and additional depreciation and amortization and facilities costs related to the increase in the number of employees.

**Gross Profit**

	Year Ended December 31, 2014		2013		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Software services	\$ 75,235	60.1%	\$ 61,564	63.0%	\$ 13,671	22.2%
Professional services	(25,285)	(205.0)	(19,223)	(273.1)	(6,062)	31.5
Gross profit	\$ 49,950	36.3%	\$ 42,341	40.4%	\$ 7,609	18.0%

The increase in software services gross profit in absolute terms was driven by a \$27.4 million, or 28.0%, increase in software services revenue. This increase was partially offset by a \$13.7 million, or 37.9%, increase in software services cost of revenue. Software services cost of revenue included \$0.4 million and \$0.1 million of stock-based compensation expense for the years ended December 31, 2014 and 2013, respectively, and \$7.2 million and \$6.7 million of depreciation and amortization for the years ended December 31, 2014 and 2013, respectively.

The increase in professional services gross loss was driven by an \$11.4 million, or 43.3%, increase in professional services cost of revenue, partially offset by an increase in professional services revenue of \$5.3 million. Professional services cost of revenue included \$0.5 million and \$0.2 million of stock-based compensation expense for the years ended December 31, 2014 and 2013, respectively. In addition, professional services cost of revenue included \$0.8 million and \$0.4 million in depreciation and amortization for the years ended December 31, 2014 and 2013, respectively. As discussed in Components of Operating Results Cost of Revenue, our cost of revenue is expensed as we incur the costs. However, the related revenue from fees we receive for our implementation services performed before a customer is operating on our platform is deferred until the commencement of the monthly subscription and recognized as revenue ratably over the longer of the related contract term or the estimated expected life of the customer relationship, which is 10 years for the years presented. Therefore, the cost incurred in providing these services is expensed in periods prior to the recognition of the corresponding revenue. For this reason, as well as due to the personnel-related costs associated with providing implementation services, our cost associated with providing implementation services has been significantly higher as a percentage of related revenue than our cost associated with providing our monthly subscription services.

**Segment Gross Profit**

	Year Ended December 31, 2014		2013		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Employer	\$ 16,186	26.1%	\$ 13,316	32.8%	\$ 2,870	21.6%
Carrier	33,764	44.8	29,025	45.3	4,739	16.3
Gross profit	\$ 49,950	36.3%	\$ 42,341	40.4%	\$ 7,609	18.0%

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Employer gross profit increased in absolute terms by \$2.9 million, or 21.6%, between the year ended December 31, 2013 and the year ended December 31, 2014. The \$21.4 million, or 52.5%, increase in employer revenue was offset by an \$18.5 million, or 67.6%, increase in employer cost of revenue. The increase in cost of revenue is attributable to costs associated with supporting the increased number of employer customers live on the platform and the increased cost of providing services, including customer implementations. Our employer gross profit included \$3.5 million and \$2.5 million of depreciation and amortization for the years ended December 31, 2014 and December 31, 2013, respectively. In addition, our employer gross profit included \$0.5 million and \$0.1 million of stock-based compensation expense for the years ended December 31, 2014 and 2013, respectively.

Carrier gross profit increased by \$4.7 million, or 16.3%, between the year ended December 31, 2013 and the year ended December 31, 2014. The \$11.3 million, or 17.6%, increase in carrier revenue was offset by a \$6.6 million, or 18.7%, increase in carrier cost of revenue. The increase in cost of revenue is attributable to costs associated with supporting the increased number of carrier customers live on the platform and the increased cost of providing services, including customer implementations. Our carrier gross profit included \$4.5 million and \$4.6 million in depreciation and amortization for the years ended December 31, 2014 and December 31, 2013, respectively. In addition, our carrier gross profit included \$0.4 million and \$0.2 million of stock-based compensation expense for the years ended December 31, 2014 and 2013, respectively.

**Operating Expenses**

	Year Ended December 31,		2013		Period-to-Period Change	
	2014	Percentage of Revenue	2013	Percentage of Revenue	Amount	Percentage
	Amount	(in thousands)	Amount			
Sales and marketing	\$ 48,467	35.3%	\$ 36,072	34.4%	\$ 12,395	34.4%
Research and development	\$ 41,729	30.4%	\$ 23,532	22.5%	\$ 18,197	77.3%
General and administrative	\$ 18,657	13.6%	\$ 10,974	10.5%	\$ 7,683	70.0%

The increase in sales and marketing expense was primarily attributable to a \$7.7 million increase in salaries and personnel-related costs, including an increase in stock-based compensation of \$1.2 million, due to sales and marketing associates hired to continue driving revenue growth and \$1.8 million related to sales and marketing events, \$1.9 million related to increases in facilities and overhead allocation, recruiting and other operating costs driven by an increase in the number of employees, and \$0.8 million in travel-related costs.

The increase in research and development expense was primarily attributable to a \$10.8 million increase in salaries and personnel-related costs, including an increase in stock-based compensation of \$1.1 million, due to additional research and development headcount. Additionally, we experienced a \$5.5 million increase in engineering consulting fees for assistance in product development and \$1.8 million related to increases in facilities and overhead allocation, other operating costs, and travel-related costs driven by an increase in the number of employees.

The increase in general and administrative expense was primarily attributable to a \$3.1 million increase in consulting and professional fees and insurance related to being a publicly traded company, including \$0.7 million in costs related to our follow-on offering on July 17, 2014. We also experienced a \$3.0 million increase in salaries and personnel-related costs, including a \$1.3 million increase in stock-based compensation expense due to increased headcount. In addition, we experienced a \$1.2 million increase related primarily to increases in facilities and overhead costs.

**Table of Contents****Comparison of Years Ended December 31, 2013 and 2012****Revenue**

	Year Ended December 31, 2013		2012		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Software services	\$ 97,713	93.3%	\$ 75,931	92.9%	\$ 21,782	28.7%
Professional services	7,039	6.7	5,808	7.1	1,231	21.2
<b>Total revenue</b>	<b>\$ 104,752</b>	<b>100.0%</b>	<b>\$ 81,739</b>	<b>100.0%</b>	<b>\$ 23,013</b>	<b>28.2%</b>

Growth in both software services and professional services revenues year over year was primarily attributable to the addition of new customers, as the number of large employer and carrier customers increased to 433 as of December 31, 2013 from 320 as of December 31, 2012.

**Segment Revenue**

	Year Ended December 31, 2013		2012		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Employer	\$ 40,656	38.8%	\$ 23,760	29.1%	\$ 16,896	71.1%
Carrier	64,096	61.2	57,979	70.9	6,117	10.6
<b>Total revenue</b>	<b>\$ 104,752</b>	<b>100.0%</b>	<b>\$ 81,739</b>	<b>100.0%</b>	<b>\$ 23,013</b>	<b>28.2%</b>

The growth in employer revenue for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to a \$16.5 million increase in our employer software services revenue driven primarily by an increase in the number of large employer customers using our platform as of December 31, 2013 as compared to December 31, 2012. The growth in carrier revenue year over year was primarily attributable to an increase of \$5.3 million in our carrier software services revenue, driven primarily by an increase in the number of carrier customers using our platform as well as an increase in the number of products being utilized by our carrier customers during the year ended December 31, 2013 as compared to the year ended December 31, 2012.

**Cost of Revenue**

	Year Ended December 31, 2013		2012		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Cost of revenue	\$ 62,411	59.6%	\$ 44,400	54.3%	\$ 18,011	40.6%

The increase in cost of revenue for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to a \$10.7 million increase in salaries and personnel-related costs and a \$4.6 million increase in professional fees. Customer services salaries and personnel-related costs increased \$6.8 million and professional fees increased by \$2.6 million to support a growing number of customers and to prepare for and assist with an open enrollment period at a large customer. Engineering salaries and personnel-related costs increased \$3.4 million and professional fees increased by \$1.8 million to perform customer implementations for a certain large





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employer customer and for our Marketplace product at carrier customers. In addition, we experienced a \$0.4 million increase in telecommunications and other expense related to increased open enrollment volume and \$0.6 million increase in travel expenses to client sites. Further, we experienced a \$1.3 million increase in infrastructure maintenance costs to support our products and platform and a \$0.8 million increase in facilities expenses as a result of adding office space. Additional hiring led to a \$0.2 million increase in recruiting costs. These increases were partially offset by a net decrease of \$0.5 million in amortization expense primarily due to an impairment charge during the year ended December 31, 2012 related to capitalized software development costs offset by additions to property and equipment related to our growth.

**Gross Profit**

	Year Ended December 31, 2013		2012		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Software services	\$ 61,564	63.0%	\$ 47,115	62.0%	\$ 14,449	30.7%
Professional services	(19,223)	(273.1)	(9,776)	(168.3)	(9,447)	96.6
Gross profit	\$ 42,341	40.4%	\$ 37,339	45.7%	\$ 5,002	13.4%

The increase in software services gross profit for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was driven by a \$21.8 million, or 28.7%, increase in software services revenue, partially offset by a \$7.3 million, or 25.5%, increase in software services cost of revenue. Software services cost of revenue included \$93,000 and \$100,000 of stock-based compensation expense for the years ended December 31, 2013 and 2012, respectively; and \$6.7 million and \$7.2 million of depreciation and amortization for the years ended December 31, 2013 and 2012, respectively. The net decrease in depreciation and amortization expense was primarily due to an impairment charge during the year ended December 31, 2013 related to capitalized software development costs partially offset by additions to property and equipment related to our growth.

The increase in professional services gross loss for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was driven by a \$10.7 million, or 68.5%, increase in professional services cost of revenue, partially offset by a \$1.2 million, or 21.2%, increase in professional services revenue. Professional services cost of revenue included \$181,000 and \$95,000 of stock-based compensation expense for the years ended December 31, 2013 and 2012, respectively. In addition, professional services cost of revenue included approximately \$0.4 million in depreciation and amortization for the years ended December 31, 2013 and 2012.

**Segment Gross Profit**

	Year Ended December 31, 2013		2012		Period-to-Period Change	
	Amount	Percentage of Revenue (in thousands)	Amount	Percentage of Revenue	Amount	Percentage
Employer	\$ 13,316	32.8%	\$ 9,810	41.3%	\$ 3,506	35.7%
Carrier	29,025	45.3	27,529	47.5	1,496	5.4
Gross profit	\$ 42,341	40.4%	\$ 37,339	45.7%	\$ 5,002	13.4%

The increase in employer gross profit for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was driven by a \$16.9 million, or 71.1%, increase in employer revenue, partially offset by a \$13.4 million, or 96.0%, increase in employer cost of revenue. The

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increase in cost of revenue was primarily attributable to costs associated with providing implementation services, which increased due to a higher number of new individual employer customer implementations. Our employer gross profit included \$2.5 million and \$1.9 million of depreciation and amortization for the years ended December 31, 2013 and 2012, respectively. In addition, our employer gross profit included \$115,000 and \$60,000 of stock-based compensation expense for the years ended December 31, 2013 and 2012, respectively.

The increase in carrier gross profit year over year was driven by a \$6.1 million, or 10.6%, increase in carrier revenue, partially offset by a \$4.6 million, or 15.2%, increase in carrier cost of revenue. The increase in cost of revenue is primarily attributable to new individual carrier customer and product implementations, including our Marketplace product. Our carrier gross profit included \$4.6 million and \$5.7 million in depreciation and amortization for the years ended December 31, 2013 and 2012, respectively. In addition, our carrier gross profit included \$159,000 and \$135,000 of stock-based compensation expense for the years ended December 31, 2013 and 2012, respectively.

**Operating Expenses**

	Year Ended December 31,		2012		Period-to-Period Change	
	2013	Percentage of	Amount	Percentage of	Amount	Percentage
	Amount	Revenue	Amount	Revenue	Amount	Percentage
	(in thousands)					
Sales and marketing	\$ 36,072	34.4%	\$ 27,905	34.1%	\$ 8,167	29.3%
Research and development	\$ 23,532	22.5%	\$ 14,621	17.9%	\$ 8,911	60.9%
General and administrative	\$ 10,974	10.5%	\$ 7,494	9.2%	\$ 3,480	46.4%

The increase in sales and marketing expense for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to a \$5.1 million increase in commissions and sales bonus expenses due to increased sales year over year. We also hired sales and marketing personnel to continue driving revenue growth, leading to a \$1.5 million increase in salaries and personnel related costs. The additional hiring resulted in a \$0.5 million increase in recruiting costs.

The increase in research and development expense for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to a \$6.0 million increase in salaries and personnel-related costs, a \$0.3 million increase in recruiting costs, and a \$1.7 million increase in engineering consulting fees, all related to continued product development and feature enhancement. Additionally, we experienced a \$0.3 million increase in travel expenses to client sites and a \$0.3 million increase in facilities expenses and depreciation as a result of adding office space and equipment to accommodate increased headcount.

The increase in general and administrative expense for the year ended December 31, 2013 as compared to the year ended December 31, 2012 was primarily attributable to a \$1.8 million increase in salaries and personnel-related costs associated with an increase in general and administrative personnel to support our growing business and an increase in performance-driven management bonuses. We also experienced a \$0.2 million increase in stock-based compensation expense due to grants made in October 2012, May 2013, and August 2013 to incentivize our management. In addition, we experienced a \$0.8 million increase in consulting and professional fees and a \$0.3 million increase in travel costs incurred in connection with our IPO. Further, other operating expense increased by \$0.2 million year over year primarily due to increased insurance costs.

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### **Critical Accounting Policies and Significant Judgments and Estimates**

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses. In accordance with GAAP, we base our estimates on historical experience and on various other assumptions that we believe reasonable under the circumstances. Actual results might differ from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K, we believe the following accounting policies are critical to the process of making significant judgments and estimates in the preparation of our consolidated financial statements.

#### ***Revenue Recognition and Deferred Revenue***

We derive the majority of our revenue from software services fees, which consist primarily of monthly subscription fees paid to us by our customers for access to, and usage of, our cloud-based benefits software solutions for a specified contract term. We also derive revenue from professional services which primarily include fees related to the implementation of our customers onto our platform, which typically includes discovery, configuration and deployment, integration, testing, and training.

We recognize revenue when there is persuasive evidence of an arrangement, we have provided the service, the fees to be paid by the customer are fixed and determinable and collectability is reasonably assured. We consider that delivery of our cloud-based software services has commenced once we have granted the customer access to our platform.

We generally recognize software services fees monthly based on the number of employees covered by the relevant benefits plans at contracted rates for a specified period of time once the criteria for revenue recognition described above have been satisfied. We defer recognition of our professional services fees and begin recognizing them once the services are performed and related software services have commenced, ratably over the longer of the contract term or the estimated expected life of the customer relationship.

We estimate our customer relationship period based on various factors including, but not limited to, contract terms, contract extensions and renewals, customer attrition, the nature and pace of technology advancements and obsolescence, and the anticipated impact of demand, competition, and other regulatory and economic factors.

Most of our deferred revenue relates to professional services performed for our carrier customers, which require a more extensive and lengthy implementation. We will evaluate the term over which revenue is recognized for our implementation fees as we gain more experience with customer contract renewals.

In January 2015, we adjusted the estimated expected life of the customer relationship period for both segments. This change in estimate was the result of analyzing recent quantitative and qualitative observations in the market and factors impacting our business. This change in estimate shortens the term over which deferred revenue will be recognized from 10 to 7 years and will be applied prospectively to unamortized professional services fees over the longer of the contract term or the adjusted estimated expected life of the customer relationship.

#### ***Accounts Receivable and Allowances for Doubtful Accounts and Returns***

We state accounts receivable at realizable value, net of an allowance for doubtful accounts that we maintain for estimated losses expected to result from the inability of some customers to make

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payments as they become due. We base our estimated allowance on our analysis of past due amounts and ongoing credit evaluations. Historically, our actual collection experience has not varied significantly from our estimates, due primarily to our credit and collection policies and the financial strength of our customers.

The allowances for returns are accounted for as reductions of revenue and are estimated based on the Company's periodic assessment of historical experience and trends. The Company considers factors such as the time lag since the initiation of revenue recognition, historical reasons for adjustments, new customer volume, complexity of billing arrangements, timing of software availability, and past due customer billings.

### ***Goodwill***

Goodwill represents the excess of the aggregate of the fair value of consideration transferred in a business combination over the fair value of assets acquired, net of liabilities assumed. Goodwill is not amortized, but is subject to an annual impairment test. We test goodwill for impairment at the reporting unit level annually on October 31, or more frequently if events or changes in business circumstances indicate the asset might be impaired.

When testing goodwill for impairment, we first perform an assessment of qualitative factors, including but not limited to, macroeconomic conditions, industry and market conditions, company-specific events, changes in strategy and circumstances, revenue, and operating margins. If qualitative factors indicate that it is more likely than not that the fair value of the relevant reporting unit is less than its carrying amount, we test goodwill for impairment at the reporting unit level using a two-step approach. In step one, we determine if the fair value of the reporting unit exceeds the unit's carrying value. If step one indicates that the fair value of the reporting unit is less than its carrying value, we perform step two, determining the fair value of goodwill and, if the carrying value of goodwill exceeds the implied fair value, recording an impairment charge.

We have determined that we have two operating segments, employer and carrier. Further, we have identified that the employer operating segment contains a component, Benefit Informatics. To determine the fair value of our reporting units, we primarily use a discounted cash flow analysis, which requires significant assumptions and estimates about future operations. Significant judgments inherent in this analysis include the determination of an appropriate discount rate, estimated terminal value and the amount and timing of expected future cash flows.

### ***Stock-Based Compensation***

We have issued two types of stock-based awards under our stock plans: stock options and restricted stock units. Stock-based awards granted to associates, directors, and non-associate third parties are measured at fair value at each grant date. We recognize stock-based compensation expense, net of forfeitures, ratably over the requisite service period of the option award. Generally, options vest 25% on the one-year anniversary of the grant date with the balance vesting over the following 36 months. We previously granted options that vest 100% on the fifth anniversary of the grant date. Restricted stock unit awards generally vest 25% on each anniversary of the grant date over 4 years.

### ***Determination of the Fair Value of Stock-Based Compensation Grants***

Prior to our IPO, we were a private company with no active public market for our common stock. We have periodically determined for financial reporting purposes the estimated per share fair value of our common stock at various dates using contemporaneous valuations performed in accordance with

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the guidance outlined in the American Institute of Certified Public Accountants Practice Aid, Valuation of Privately Held Company Equity Securities Issued as Compensation, or the Practice Aid. When determining the fair market value of our common stock, we considered what we believe to be comparable publicly traded companies, discounted free cash flows, and an analysis of our enterprise value.

Since our IPO, we determined fair value for restricted stock unit awards based on the closing price of our common stock on the date of grant or, if not a trading day, the trading day preceding the grant date.

The determination of the fair value of stock-based compensation arrangements is affected by a number of variables, including estimates of the fair value of our common stock, expected stock price volatility, risk-free interest rate, and the expected life of the award. We value stock options using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Black-Scholes and other option valuation models require the input of highly subjective assumptions, including the expected stock price volatility.

The following summarizes the assumptions used for estimating the fair value of stock options granted during the periods indicated (we did not grant any stock options in 2014):

	Year Ended December 31,	
	2013	2012
Risk-free interest rate	1.0% - 1.7%	0.8% - 1.2%
Expected term (years)	6.08	6.08
Expected volatility	52%	53% - 55%
Dividend yield	0%	0%
Weighted-average grant date fair value per share	\$ 7.71	\$ 4.24

We have assumed no dividend yield because we do not expect to pay dividends in the foreseeable future, which is consistent with our past practice. The risk-free interest rate assumption is based on observed interest rates for constant maturity U.S. Treasury securities consistent with the expected life of our associate 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 midpoint between the vesting date and the end of the contractual term. We used 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. Expected volatility is based on historical volatilities for publicly traded stock of comparable companies over the estimated expected life of the stock options. The list of comparable companies we used to determine expected volatility was consistent with those used to determine the corresponding fair value of our common stock at each grant date.

We based our estimate of pre-vesting forfeitures, or forfeiture rate, on our analysis of historical behavior by stock award holders. We apply the estimated forfeiture rate to the total estimated fair value of the awards, as derived from the Black-Scholes model, to compute the stock-based compensation expense, net of pre-vesting forfeitures, to be recognized in our consolidated statements of operations.

Based upon our closing stock price on December 31, 2014 of \$32.84, the aggregate intrinsic value of outstanding options to purchase shares of our common stock as of December 31, 2014 was \$60.7 million, of which \$53.7 million related to vested options and \$7.0 million to unvested options. The aggregate intrinsic value of outstanding restricted stock units as of December 31, 2014 was \$23.7 million, of which all were unvested.

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### ***Income Taxes***

We account for income taxes under the asset and liability method. We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as for operating loss and tax credit carryforwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which we expect to recover or settle those temporary differences. We recognize the effect of a change in tax rates on deferred tax assets and liabilities in the results of operations in the period that includes the enactment date. We reduce the measurement of a deferred tax asset, if necessary, by a valuation allowance if it is more likely than not that we will not realize some or all of the deferred tax asset.

We account for uncertain tax positions by recognizing the financial statement effects of a tax position only when, based upon technical merits, it is more likely than not that the position will be sustained upon examination. We recognize potential accrued interest and penalties associated with unrecognized tax positions within our global operations in income tax expense.

### **Liquidity and Capital Resources**

#### ***Sources of Liquidity***

As of December 31, 2014, our primary sources of liquidity were our cash and cash equivalents totaling \$51.1 million and \$5.1 million in marketable securities, \$21.3 million in accounts receivables, net of allowance, and unused revolving line of credit of \$12.5 million. The terms of our revolving line of credit are described in Note 8 of our consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

Prior to our IPO, we funded our operations primarily through cash from operating activities, bank and subordinated debt borrowings, and private placements of redeemable convertible preferred stock. From 2007 to 2010, we raised \$135.5 million from the sale of redeemable convertible preferred stock to third parties.

On September 23, 2013, we closed our IPO in which we sold 3,000,000 shares of common stock at a public offering price of \$26.50 per share, resulting in net proceeds of \$70.1 million. See Note 1 of our consolidated financial statements included elsewhere in this Annual Report on Form 10-K for additional details regarding our IPO.

In February 2015, the existing revolving line of credit was replaced with a senior revolving line of credit, or Senior Revolver, with a syndicate of lenders led by the existing lender. The three-year Senior Revolver has a borrowing limit of \$60.0 million. Borrowing capacity under the Senior Revolver is subject to a borrowing base limit that is a function of our monthly recurring revenue as adjusted to reflect lost customer revenue during the previous three calendar months. Therefore, credit available under the line of credit may be less than the \$60 million borrowing limit. The outstanding indebtedness under the existing revolving line of credit was repaid with proceeds from the Senior Revolver and the existing revolving line of credit was terminated. Interest is payable monthly. Advances under the Senior Revolver bear interest at the prime rate as published in the Wall Street Journal plus a margin based on our liquidity that ranges between 1.0% and 1.5%. We are charged for amounts unused under this arrangement at a rate based on our liquidity of 0.300% to 0.375% per year. Any outstanding principal is due at the end of the term.

We are bound by customary affirmative and negative covenants in connection with the Senior Revolver, including financial covenants related to liquidity and EBITDA. In the event of a default, the lenders may declare all obligations immediately due and stop advancing money or extending credit under the line of credit. The line of credit is collateralized by substantially all of our tangible and intangible assets, including intellectual property and the equity of our subsidiaries.

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On February 24, 2015, we entered into a Securities Purchase Agreement to sell shares of our common stock to Mercer, one of our customers. Pursuant to the agreement, on the same date, we sold 2,817,526 shares of our common stock to Mercer for \$26.50 per share or an aggregate of approximately \$74.7 million. At the same time, we also issued Mercer a warrant to purchase up to an additional 580,813 shares of our common stock for \$26.50 per share at any time during the 30-month term of the warrant. The agreement, among other things, includes certain standstill provisions and prevents Mercer from disposing of its shares of our common stock until the earlier of December 31, 2017, the expiration or termination of the Mercer Exchange Software as a Service Agreement, as amended between us and Mercer Health & Benefits, LLC, the date on which Mercer and its affiliates own less than 75% of the shares it purchased pursuant to the Securities Purchase Agreement, and the date on which Mercer and its affiliates own less than 5% of our outstanding common stock. We received all of the proceeds from this sale of shares and will use the proceeds for working capital and other general corporate purposes.

Based on our current level of operations and anticipated growth, we believe our future cash flows from operating activities and existing cash balances, which include the net proceeds from our IPO, will be sufficient to meet our cash requirements for at least the next 12 months.

Going forward, we may access capital markets to raise additional equity or debt financing for various business reasons, including required debt payments and acquisitions. The timing, term, size, and pricing of any such financing will depend on investor interest and market conditions, and there can be no assurance that we will be able to obtain any such financing.

**Cash Flows**

Our cash flows for the years ended December 31, 2014, 2013, and 2012 were as follows:

	Year Ended December 31,		
	2014	2013	2012
	(in thousands)		
Cash (used in) provided by:			
Operating activities	\$ (18,878)	\$ 1,067	\$ 12,408
Investing activities	(1,953)	(22,077)	(6,308)
Financing activities	6,260	66,952	(2,253)
Net (decrease) increase in cash and cash equivalents	\$ (14,571)	\$ 45,942	\$ 3,847

**Operating Activities**

For the year ended December 31, 2014, our operating activities used \$18.9 million of cash, as \$24.8 million of cash provided by changes in working capital and \$19.5 million in adjustments for non-cash items, were more than offset by a net loss of \$63.2 million. Adjustments for non-cash items primarily consisted of depreciation and amortization expense of \$9.5 million, non-cash stock compensation expense of \$5.6 million, change in fair value and accretion of warrant of \$0.7 million, and accrual of interest on financing obligations of \$3.6 million. The cash provided by changes in working capital primarily consisted of an increase in deferred revenue of \$14.3 million, an increase in accrued compensation and benefits of \$3.2 million, an increase in accrued expenses of \$2.5 million, and a decrease in accounts receivable of \$2.4 million. The increase in deferred revenue was a result of contracts closed during the period with associated upfront fees, which will be recognized as revenue, ratably over the customer relationship period, beginning once the software services have commenced. The increase in accrued compensation and benefits resulted from an increase in the number of associates. The decrease in accounts receivable resulted from normal timing of customer payments. The increase in accrued expenses resulted from an increase in cost of revenue and operating expenses.

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For the year ended December 31, 2013, net cash and cash equivalents provided by operating activities of \$1.1 million consisted of a net loss of \$30.4 million more than offset by \$19.4 million of cash provided by changes in working capital and \$12.1 million in adjustments for non-cash items. Adjustments for non-cash items primarily consisted of depreciation and amortization expense of \$8.2 million, accrued interest on financing obligation of \$1.8 million, non-cash stock compensation expense of \$1.2 million, and a change in fair value and accretion of warrant of \$0.9 million. The cash provided by changes in working capital primarily consisted of an increase in deferred revenue of \$22.7 million, an increase in accrued compensation and benefits of \$4.5 million, and an increase in accounts payable and accrued expenses of \$3.5 million. The increase in deferred revenue was a result of contracts closed during the period with associated upfront fees, which will be recognized as revenue ratably over the customer relationship period beginning once the software services have commenced. The increase in accrued compensation and benefits resulted from normal fluctuation in payroll dates and an increase in the number of associates. The increase in accounts payable resulted from an increase in cost of revenue and operating expenses. These increases were partially offset by a decrease in operating cash flow due to a \$10.3 million increase in accounts receivable. The increase in accounts receivable was primarily attributable to the growth of our revenue and fees.

For the year ended December 31, 2012, our net cash and cash equivalents provided by operating activities of \$12.4 million consisted of a net loss of \$14.9 million, more than offset by \$15.4 million of cash provided by changes in working capital and \$11.8 million in adjustments for non-cash items. Adjustments for non-cash items primarily consisted of depreciation and amortization expense of \$8.6 million, accrued interest on financing obligation of \$1.8 million, non-cash stock compensation expense of \$0.7 million and the change in fair value of contingent consideration of \$0.2 million. The increase in cash resulting from changes in working capital primarily consisted of an increase in deferred revenue of \$14.7 million and an increase in accrued compensation and benefits of \$3.1 million as a result of increased headcount. The increase in deferred revenue was a result of contracts closed during the period with associated upfront fees, which will be recognized as revenue, ratably over the customer relationship period, beginning once the software services have commenced. In addition, we experienced an increase in accounts payable and accrued expenses of \$1.4 million, primarily driven by increased operating costs during the period. These increases were partially offset by a decrease in operating cash flow due to a \$4.4 million increase in accounts receivable, primarily driven by increased revenue during the year as we continue to expand our operations.

*Investing Activities*

Net cash used in investing activities totaled \$2.0 million for 2014. For the year ended December 31, 2014, net cash used for the purchase of property and equipment was \$9.8 million partially offset by the cash provided by net maturity of short-term investments held to maturity of \$7.9 million.

Net cash used in investing activities totaled \$22.1 million for 2013. We purchased corporate bonds in the amount of \$13.2 million. In addition, we spent \$8.9 million to purchase property and equipment. For the year ended December 31, 2012, net cash used in investing activities was \$6.3 million, for the purchase of property and equipment.

*Financing Activities*

For the year ended December 31, 2014, net cash provided by financing activities was \$6.3 million, consisting of a \$14.0 million draw on revolving line of credit and \$2.8 million in proceeds from exercises of stock options, offset by \$8.2 million in payments on financing and capital lease obligations and payments on revolving line of credit of \$2.1 million.



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On March 28, 2014, a major customer exercised its warrant through a cashless exercise in accordance with the warrant's terms, resulting in the issuance of 455,521 shares of common stock. The measured value of the warrant became fully recognized against revenue in October 2014.

Net cash provided by financing activities totaled \$67.0 million for 2013, which resulted primarily from \$70.1 million in proceeds from our IPO, net of issuance costs, \$12.2 million in proceeds from line of credit and notes payable borrowings and \$0.7 million from exercises of stock options, partially offset by \$15.8 million in repayments of notes payable, line of credit, and financing and capital lease obligations and \$0.3 million in payments of contingent consideration.

For the year ended December 31, 2012, net cash used in financing activities was \$2.3 million, consisting of \$4.2 million in repayments of debt and financing and capital lease obligations, \$0.6 million in repurchases of our common stock and \$2.1 million in payments of contingent consideration related to an acquisition during the year ended December 31, 2010. These amounts were partially offset by \$4.5 million in proceeds from notes payable borrowing and \$0.1 million in cash received upon the exercise of stock options.

*Operating and Capital Expenditure Requirements*

We believe that our existing cash and cash equivalents balances and cash generated from operations will be sufficient to meet our anticipated cash requirements through at least the next 12 months. Our future capital requirements will depend on many factors, including our customer growth rate, subscription renewal activity, the timing and extent of development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced services offerings, and the continuing market acceptance of our services. We might require additional capital beyond our currently anticipated amounts. If our available cash and cash equivalents balances are insufficient to satisfy our liquidity requirements, we may seek to sell equity or convertible debt securities or enter into an additional credit facility. The sale of equity and convertible debt securities may result in dilution to our stockholders and those securities may have rights senior to those of our common shares. If we raise additional funds through the issuance of convertible debt securities, these securities could contain covenants that would restrict our operations. Additional capital may not be available on reasonable terms, or at all.

**Contractual Obligations and Commitments**

Our principal commitments consist of obligations under our outstanding debt facilities, non-cancelable leases for our office space and computer equipment and purchase commitments for our co-location and other support services. The following table summarizes these contractual obligations at December 31, 2014. Future events could cause actual payments to differ from these estimates.

Contractual Obligations	Total	Payment due by period			
		Less than 1 year	1-3 years (in thousands)	3-5 years	More than 5 years
Long-term debt Revolving line of credit (1)	\$ 17,657	\$	\$ 17,657	\$	\$
Operating lease obligations (2)	39,401	3,857	7,846	7,588	20,110
Capital lease obligations	4,944	2,621	2,321	2	
Financing obligations, build-to-suit leases (2)	87,111	5,863	12,259	13,006	55,983
Financing obligations, other	2,790	1,599	1,191		
Purchase commitments	5,001	2,621	2,380		
<b>Total</b>	<b>\$ 156,904</b>	<b>\$ 16,561</b>	<b>\$ 43,654</b>	<b>\$ 20,596</b>	<b>\$ 76,093</b>

(1) Repayment of the revolving line of credit is due at end of the term in 2016. Early repayment is allowed. Interest is paid monthly.

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- (2) Includes future minimum payments totaling \$81.5 million for office space that was under construction as of December 31, 2014. During January 2015, the Company occupied the additional office space constructed under the 15-year build-to-suit lease, signed in December 2013.

In February 2015, the Company replaced its existing revolving line of credit, or Revolver, with the Senior Revolver involving a syndicate of lenders led by the existing lender. The three-year Senior Revolver has a borrowing limit of \$60 million. Borrowing capacity under the Senior Revolver is subject to a borrowing base limit that is a function of our monthly recurring revenue as adjusted to reflect lost customer revenue during the previous three calendar months. Therefore, credit available under the Senior Revolver may be less than the \$60 million borrowing limit. The outstanding indebtedness under the Revolver will be repaid with proceeds from the Senior Revolver. Interest is payable monthly. Advances under the Senior Revolver bear interest at the prime rate as published in the Wall Street Journal plus a margin based on our liquidity that ranges between 1.0% and 1.5%. We are charged for amounts unused under this arrangement at a rate based on our liquidity of 0.300% to 0.375% per year. Any outstanding principal is due at the end of the term.

On December 13, 2013, we entered into a 15 year build-to-suit lease for additional office space at our Charleston, South Carolina campus. The estimated rentable area of the building to be constructed is approximately 145,000 square feet and the lease commenced on January 1, 2015. Future minimum under the arrangement payments total \$81.5 million are included in the contractual obligations table above. Under this lease agreement we executed an option to lease two additional adjacent buildings. The annual cost of the option is \$466,000 per year for term of the option which is three years. Additionally, we may incur a termination fee if we terminate the option or let the option expire. The termination fee of \$757,000 will be prorated through the date of termination or expiration. As of December 31, 2014, we recognized a liability related to the option in the amount of \$489,000. No amounts have been recognized related the to the termination fee. However, if we had terminated the option effective December 31, 2014, we would have incurred expense in the amount of \$265,000.

### **Off-Balance Sheet Arrangements**

As of December 31, 2014, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, such as the use of unconsolidated subsidiaries, structured finance, special purpose entities or variable interest entities other than as disclosed in Note 15 for which we are not the primary beneficiary of, nor do we have a controlling financial interest in, any variable interest entity. Accordingly, we have not consolidated any variable interest entities.

### **Recent Accounting Pronouncements**

In May 2014, the FASB issued ASU No. 2014-09 Revenue from Contracts with Customers, which amends the revenue recognition requirements in the FASB Accounting Standards Codification, or ASC. This statement requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The statement shall be applied using one of two methods: retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying this statement recognized at the date of initial application. The Company has not yet determined which method it will apply. This statement is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial position and results of operations.

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We are evaluating other accounting standards and exposure drafts that have been issued or proposed by the FASB or other standards setting bodies that do not require adoption until a future date to determine whether adoption will have a material impact on our consolidated financial statements.

### ***Item 7A. Quantitative and Qualitative Disclosures About Risk***

Market risk is the risk of loss to future earnings, values or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument might change as a result of changes in interest rates, exchange rates, commodity prices, equity prices and other market changes. We do not use derivative financial instruments for speculative, hedging or trading purposes, although in the future we might enter into exchange rate hedging arrangements to manage the risks described below.

#### ***Interest Rate Risk***

We are exposed to market risk related to changes in interest rates. Borrowings under the revolving line of credit with Silicon Valley Bank, which was entered into in August 2013, bear interest at rates that are variable. Increases in the LIBOR or Prime Rate would increase the amount of interest payable under this line of credit. Borrowings outstanding under our previous credit arrangements were not subject to interest rate risk because they bore interest at fixed rates.

#### ***Interest Rate Sensitivity***

We are subject to interest rate risk in connection with borrowings under our revolving line of credit, which are subject to a variable interest rate. At December 31, 2014, we had borrowings under our revolving line of credit of \$17.7 million. As a result, each change of one percentage point in interest rates would result in an approximate \$177,000 change in our annual interest expense on our outstanding borrowings at December 31, 2014. Any debt we incur in the future may also bear interest at variable rates.

#### ***Inflation Risk***

We do not believe that inflation has had a material effect on our business, financial condition, or results of operations. We continue to monitor the impact of inflation in order to minimize its effects through pricing strategies, productivity improvements and cost reductions. 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 set forth in the Consolidated Financial Statements and Notes thereto beginning at page F-1 of this Report.

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

None.

### ***Item 9A. Controls and Procedures***

#### ***Evaluation of Disclosure Controls and Procedures***

Under the supervision and with the participation of our management, including our President and Chief Executive Officer, and our Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on their evaluation and given the remediation of our material weakness in internal controls over the accounting for leasing transactions as of September 30, 2014, our President and Chief Executive Officer, and our Chief Financial Officer, concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer, and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures as of December 31, 2014.

#### ***Management's Annual Report on Internal Control Over Financial Reporting***

Our management, including our President and Chief Executive Officer, and our 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 President and Chief Executive Officer, and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2014, based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (1992 framework). Based on this evaluation

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under the Internal Control Integrated Framework and given the remediation of our material weakness in internal controls over the accounting for leasing transactions as of September 30, 2014, our President and Chief Executive Officer, and our Chief Financial Officer, have concluded that our internal control over financial reporting was effective as of December 31, 2014.

### *Changes in Internal Control Over Financial Reporting*

No change in internal control over financial reporting occurred during the most recent fiscal quarter with respect to our operations, which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### *Attestation Report of Registered Public Accounting Firm*

This Annual Report on Form 10-K does not include an attestation report of our independent registered public accounting firm due to an exemption established by the JOBS Act for emerging growth companies.

## ***Item 9B. Other Information***

### **Unregistered Sales of Equity Securities**

On February 24, 2015, we entered into a Securities Purchase Agreement with Mercer LLC, a Delaware limited liability company and a wholly owned subsidiary of Marsh & McLennan Companies, Inc., a Delaware corporation, or the Investor. Pursuant to the Securities Purchase Agreement, we sold and issued to the Investor 2,817,526 shares of our common stock for \$26.50 per share or an aggregate of \$74,664,439. At the same time, we also issued Mercer a warrant, or the Warrant, to purchase an additional 580,813 shares of our common stock for \$26.50 per share at any time during the 30-month term of the Warrant.

The offer and sale of the shares of our common stock and Warrant to Mercer are exempt from registration under the Securities Act pursuant to Section 4(a)(2) of the Securities Act and Rule 506 promulgated thereunder, based on the fact that the sale was to only one accredited investor.

The Securities Purchase Agreement provides as follows:

**Board Observer Right.** Until the earlier of (i) the expiration or termination of the Alliance Agreement (as defined below) and (ii) the first date on which the Investor and its affiliates own less than (A) 75% of the shares of our common stock acquired on February 24, 2015 or (B) 5% of our common stock outstanding, in each case in this clause (ii), for a period of at least 45 consecutive days, or the Termination Date, the Investor is entitled to designate an observer as outlined in the Securities Purchase Agreement, to attend all meetings of our board of directors and its committees, subject to certain exceptions.

**Standstill.** Until the Termination Date and subject to certain exceptions as set forth in the Securities Purchase Agreement, the Investor and its affiliates are restricted from, among other things, acquiring additional shares of our common stock such that they beneficially own more than 17.5% of our common stock outstanding and any shares issuable pursuant to the Warrant without consent of our board of directors, proposing to enter into, directly or indirectly, any merger or business combination involving our company, taking certain actions to seek control of our management, board of directors or policies, soliciting proxies with respect to our common stock, or joining a group for the purpose of acquiring, holding, voting or disposing of our common stock. These standstill restrictions immediately terminate in circumstances including, but not limited to, any public third-party proposal or announcement relating to a merger of business combination with our company or certain third parties acquiring shares representing 15% or more of our common stock outstanding.

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**Lockup.** Until the earlier of the Termination Date or December 31, 2017, the Investor will not sell, transfer or otherwise dispose of, directly or indirectly, any shares of our common stock or enter into any swap or other arrangement that transfers to another person any of the economic consequences of ownership thereof, except: to our company; in response to a tender or exchange offer for our common stock; as part of a merger or other transaction in which all outstanding shares of our common stock are converted into or exchanged for other consideration and is approved by our stockholders; transfers to affiliates of the Investor in accordance with the Securities Purchase Agreement; or with approval of our board of directors.

**Right of Notice.** Until the Termination Date, in the event that our board of directors initiates or participates in a process with respect to a transaction that would result in a sale of substantially all the assets of our company or would result in a change of control of our company, the Investor is entitled to notice of such process and to participate in such process on terms at least as favorable as the most favorable terms offered to any third party participating therein.

In addition, for the same period, we have agreed not to enter into any agreement providing for a change of control, unless we notify the Investor in writing at least five business days before taking such action, and consider in good faith any offer or proposal made by the Investor within such period.

**Right of First Offer.** We have granted the Investor a right of first offer with respect to certain new issuances of our equity securities, as have our majority stockholder and other large stockholders with respect to sales of their shares of our common stock pursuant to Right of First Offer Agreement. In general, we and the applicable stockholders are required to offer the Investor the right to purchase any shares of our common stock or other equity securities of our company that we or such stockholders propose to issue or sell, at a price we or the stockholders, as applicable, specify, and if the Investor declines to purchase such shares or other securities at such price, we or the stockholders may issue or sell such securities to one or more third parties at a price no less than the price offered to the Investor. These rights of first offer are subject to the limitation on acquisitions of additional shares of common stock by the Investor under the standstill restrictions described above, and are also subject to certain other exceptions, including only applying to 50% of shares or other securities proposed to be sold by any stockholder in a registered offering or certain other similar forms of sales. These rights of first offer will remain in effect until the Termination Date, subject to certain exceptions.

**Other Provisions.** The Securities Purchase Agreement contains customary representations, warranties, covenants and other agreements of each of the parties thereto.

### **Amendment to Rights Agreement**

On February 24, 2015, the parties to our existing Investors Rights Agreement, dated September 18, 2013, or Rights Agreement, entered into an amendment to the Rights Agreement to (i) provide that the Investor is now party to and bound by the Rights Agreement, (ii) alter the thresholds surrounding registration rights of the stockholders who are party to the Rights Agreement, and (iii) eliminate the termination period of the Rights Agreement.

### **Alliance Agreement**

In connection with the Securities Purchase Agreement, we entered into an amendment of the Mercer Exchange Software as a Service Agreement, or Alliance Agreement, with Mercer Health & Benefits LLC, a Delaware limited liability company and an affiliate of the Investor, or Mercer Health. The amendment to the Alliance Agreement, among other things, expands certain terms and conditions of the existing relationship between our company and Mercer Health.

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The description of the Securities Purchase Agreement, Warrant, Right of First Offer Agreement and the amendment to the Rights Agreement, collectively, the Transaction Documents, is qualified in its entirety by reference to the full and complete terms of such agreements, which are filed as exhibits hereto and incorporated herein by reference. The representations, warranties and covenants contained in the Transaction Documents are made only for purposes of that agreement and as of specific dates, are solely for the benefit of the parties to such Transaction Documents, may be subject to limitations agreed upon by the parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties instead of establishing these matters as facts, and may be subject to standards of materiality applicable to the parties that differ from those applicable to investors. Investors should not rely on the representations, warranties and covenants or any description thereof as characterizations of the actual state of facts or condition of the parties to the Transaction Documents or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Transaction Documents, and such subsequent information may not be fully reflected in public disclosures by the parties to the Transaction Documents.

**Table of Contents****PART III****Item 10. Directors, Executive Officers and Corporate Governance**

Information required by this Item concerning our directors is incorporated by reference from the sections captioned "Election of Directors" and "Corporate Governance Matters" contained in our proxy statement related to the 2015 Annual Meeting of Stockholders currently scheduled to be held on June 12, 2015 which we intend to file with the Securities and Exchange Commission within 120 days of the end of our fiscal year pursuant to General Instruction G(3) of Form 10-K.

Our board of directors has determined that of the members of the Audit Committee, Messrs. Pelzer, Swad and Dennerline are independent within the meaning of the NASDAQ Stock Market listing rules and meet the additional test for independence for audit committee members imposed by Securities and Exchange Commission regulation and the NASDAQ Stock Market listing rules. Our board has also determined that the Mr. Pelzer is an "audit committee financial expert" as defined in Item 407(d)(5)(ii) of Regulation S-K.

We have adopted a code of ethics relating to the conduct of our business by all of our employees, officers, and directors, as well as a code of conduct specifically for our principal executive officer and senior financial officers. Each of these policies is posted on our website, [www.benefitfocus.com](http://www.benefitfocus.com).

The information required by this Item concerning our executive officers is set forth at the end of Part I of this Annual Report on Form 10-K.

The information required by this Item concerning compliance with Section 16(a) of the United States Securities Exchange Act of 1934, as amended, is incorporated by reference from the section of the proxy statement captioned "Section 16(a) Beneficial Ownership Reporting Compliance".

**Item 11. Executive Compensation**

The information required by this Item is incorporated by reference to the information under the sections captioned "Executive Compensation" and "Director Compensation" in the proxy statement.

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

The following table sets forth the indicated information as of December 31, 2014 with respect to our equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
<b>Equity compensation plans approved by security holders</b>			
2012 Stock Plan, as amended	1,370,413	\$ 4.95	1,966,602
Amended and Restated 2000 Stock Option Plan	1,732,838	\$ 6.24	
<b>Total</b>	<b>3,103,251</b>	<b>\$ 5.67</b>	<b>1,966,602</b>



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Our equity compensation plans consist of the 2012 Stock Plan, as amended and the Amended and Restated 2000 Stock Option Plan, which were approved by our stockholders. We do not have any equity compensation plans or arrangements that have not been approved by our stockholders.

The other information required by this Item is incorporated by reference to the information under the section captioned Security Ownership of Certain Beneficial Owners and Management contained in the proxy statement.

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

The information required by this Item is incorporated by reference to the information under the section captioned Certain Relationships and Related Party Transactions and Corporate Governance Matters in the proxy statement.

***Item 14. Principal Accounting Fees and Services***

The information required by this Item is incorporated by reference to the information under the section captioned Audit Committee Report in the proxy statement.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Schedules****(a) 1. Financial Statements.**

The following statements are filed as part of this Annual Report on Form 10-K:

**AUDITED CONSOLIDATED FINANCIAL STATEMENTS**

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets as of December 31, 2014 and 2013</u>	F-3
<u>Consolidated Statements of Operations and Comprehensive Loss for the Years Ended December 31, 2014, 2013 and 2012</u>	F-4
<u>Consolidated Statements of Changes in Stockholders' (Deficit) Equity for the Years Ended December 31, 2014, 2013 and 2012</u>	F-5
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2014, 2013 and 2012</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

**2. Financial Statement Schedules.**

<u>Schedule II-Valuation and Qualifying Accounts</u>	F-35
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Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

**(b) Exhibits**

Exhibit Number	Exhibit Title	Form	Incorporated by Reference		
			File	Exhibit	Filing Date
2.1	Agreement and Plan of Merger, dated August 29, 2013 by and among Benefitfocus.com, Inc., Benefitfocus, Inc., and Benefitfocus Mergeco, Inc.	S-1/A	333-190610	2.1	September 5, 2013
3.1.3	Restated Certificate of Incorporation of Benefitfocus, Inc.	10-Q		3.1.3	November 12, 2013
3.2	Amended and Restated Bylaws of Benefitfocus, Inc.	S-1/A	333-190610	3.2	September 5, 2013
4.1	Specimen Certificate for Common Stock.	S-1/A	333-190610	4.1	September 5, 2013
4.3	Form of Second Amended and Restated Investors' Rights Agreement, dated _____, 2013, by and among Benefitfocus, Inc. and certain stockholders named therein.	S-1/A	333-190610	4.3	September 16, 2013
4.3.1	First Amendment to Second Amended and Restated Investors' Rights Agreement, dated February 24, 2015, by and among Benefitfocus, Inc. and certain stockholders named therein.				Filed herewith
4.5	Warrant for the Purchase of Shares of Common Stock of Benefitfocus, Inc. issued February 24, 2015.				Filed herewith

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Exhibit Number	Exhibit Title	Form	Incorporated by Reference		
			(Unless Otherwise Indicated)		
			File	Exhibit	Filing Date
10.2	Form of Second Amended and Restated Voting Agreement, dated _____, 2013, by and among Benefitfocus, Inc., and certain stockholders named therein.	S-1/A	333-190610	10.2	September 5, 2013
10.3	Amended and Restated 2000 Stock Option Plan.#	S-1	333-190610	10.3	August 14, 2013
10.4	2012 Stock Plan, as amended.#	DEF 14A			April 25, 2014
10.5	Form of Grant Notice and Stock Option Agreement under the Amended and Restated 2000 Stock Option Plan.#	S-1	333-190610	10.5	August 14, 2013
10.6	Form of Grant Notice and Stock Option Agreement under the 2012 Stock Plan, as amended.#	S-1	333-190610	10.6	August 14, 2013
10.7	Form of Management Incentive Bonus Program.#	S-1	333-190610	10.7	August 14, 2013
10.7.1	Benefitfocus, Inc. Management Incentive Bonus Program.#	DEF 14A			April 25, 2014
10.8	Employment Agreement, dated January 19, 2007, by and between Benefitfocus.com, Inc. and Mason R. Holland, Jr.#	S-1	333-190610	10.8	August 14, 2013
10.9	Employment Agreement, dated January 19, 2007, by and between Benefitfocus.com, Inc. and Shawn A. Jenkins.#	S-1	333-190610	10.9	August 14, 2013
10.10	Employment Agreement, dated November 16, 2011, by and between Benefitfocus.com, Inc. and Milton A. Alpern.#	S-1	333-190610	10.10	August 14, 2013
10.11	Form of Employment Agreement.#	S-1	333-190610	10.11	August 14, 2013
10.12	Form of Indemnification Agreement.#	S-1	333-190610	10.12	August 14, 2013
10.13	Lease between Daniel Island Executive Center, LLC and Benefitfocus.com, Inc., dated as of January 1, 2009, as amended.	S-1	333-190610	10.13	August 14, 2013
10.14	Lease between Daniel Island Executive Center, LLC and Benefitfocus.com, Inc., dated as of May 31, 2005.	S-1	333-190610	10.14	August 14, 2013
10.15	Master Business Agreement between Aetna Life Insurance Company and Benefitfocus.com, Inc., dated as of November 28, 2006.	S-1	333-190610	10.15	August 14, 2013

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Exhibit Number	Exhibit Title	Form	Incorporated by Reference		
			(Unless Otherwise Indicated)		
			File	Exhibit	Filing Date
10.16	Master Guidance Line of Credit Agreement between Benefitfocus.com, Inc. and NBSC, a division of Synovus Bank, dated as of November 21, 2012 and the form of the Security Agreement and Promissory Notes thereunder.	S-1	333-190610	10.16	August 14, 2013
10.17	Loan and Security Agreement between Silicon Valley Bank, Benefitfocus.com, Inc., Benefit Informatics, Inc., and Benefitfocus, Inc., dated as of August 27, 2013.	S-1/A	333-190610	10.17	September 5, 2013
10.18	Second Amendment Agreement between Silicon Valley Bank, Benefitfocus.com, Benefit Informatics, Inc., and Benefitfocus, Inc., dated December 10, 2013.	8-K		10.18	December 12, 2013
10.19	Lease between DIEC II, LLC and Benefitfocus.com, Inc., dated as of December 13, 2013.	10-K		10.19	March 21, 2014
10.20	Securities Purchase Agreement, dated as of February 24, 2015, by and among Benefitfocus, Inc. and Mercer LLC.				Filed herewith
10.21	Right of First Offer Agreement, dated as of February 24, 2015, by and among Benefitfocus, Inc., Mercer LLC, GS Capital Partners VI Parallel, L.P., GS Capital Partners VI GmbH & Co. KG, GS Capital Partners VI Fund, L.P., GS Capital Partners VI Offshore Fund, L.P., Oak Investment Partners XII, Limited Partnership and certain stockholders named therein.				Filed herewith
21.1	List of Subsidiaries of Registrant.				Filed herewith
23.1	Consent of Ernst & Young LLP.				Filed herewith
31.1	Certification of the President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				Filed herewith

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**Incorporated by Reference**

(Unless Otherwise Indicated)

<b>Exhibit</b>					
<b>Number</b>	<b>Exhibit Title</b>	<b>Form</b>	<b>File</b>	<b>Exhibit</b>	<b>Filing Date</b>
32.1	Certification of the President and Chief Executive Officer, and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				Filed herewith
101.INS	XBRL Instance Document.				Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document.				Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.				Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.				Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.				Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.				Filed herewith

# Management contract or compensatory plan.  
 The registrant has received confidential treatment with respect to portions of this exhibit. Those portions have been omitted from the exhibit and filed separately with the U.S. Securities and Exchange Commission.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Sections 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.

**Benefitfocus, Inc.**

Date: February 27, 2015

By: /s/ Milton A. Alpern  
Milton A. Alpern  
Chief Financial Officer

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

<b>Signature</b>	<b>Capacity</b>	<b>Date</b>
/s/ Mason R. Holland, Jr.  Mason R. Holland, Jr.	Chairman of the Board of Directors	February 27, 2015
/s/ Shawn A. Jenkins  Shawn A. Jenkins	President and Chief Executive Officer (principal executive officer) and Director	February 27, 2015
/s/ Milton A. Alpern  Milton A. Alpern	Chief Financial Officer (principal financial and accounting officer)	February 27, 2015
/s/ Douglas A. Dennerline  Douglas A. Dennerline	Director	February 27, 2015
/s/ Joseph P. DiSabato  Joseph P. DiSabato	Director	February 27, 2015
/s/ Ann H. Lamont  Ann H. Lamont	Director	February 27, 2015
/s/ A. Lanham Napier  A. Lanham Napier	Director	February 27, 2015
/s/ Francis J. Pelzer V  Francis J. Pelzer V	Director	February 27, 2015
/s/ Stephen M. Swad  Stephen M. Swad	Director	February 27, 2015



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**BENEFITFOCUS, INC.**

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**CONSOLIDATED FINANCIAL STATEMENT SCHEDULE**

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Benefitfocus, Inc.

We have audited the accompanying consolidated balance sheets of Benefitfocus, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations and comprehensive loss, changes in stockholders' (deficit) equity and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Benefitfocus, Inc. at December 31, 2014 and 2013 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Raleigh, North Carolina

February 27, 2015

**Table of Contents****BENEFITFOCUS, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

	As of December 31,	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 51,074	\$ 65,645
Marketable securities	5,135	13,168
Accounts receivable, net	21,311	23,668
Prepaid expenses and other current assets	4,242	4,322
Total current assets	81,762	106,803
Property and equipment, net	54,021	27,444
Intangible assets, net	951	1,256
Goodwill	1,634	1,634
Other non-current assets	1,650	2,474
Total assets	\$ 140,018	\$ 139,611
<b>Liabilities and stockholders (deficit) equity</b>		
Current liabilities:		
Accounts payable	\$ 5,589	\$ 4,354
Accrued expenses	9,171	3,911
Accrued compensation and benefits	17,374	14,183
Deferred revenue, current portion	20,384	15,158
Financing and capital lease obligations, current portion	4,197	4,288
Total current liabilities	56,715	41,894
Deferred revenue, net of current portion	74,126	65,063
Revolving line of credit	17,657	5,757
Financing and capital lease obligations, net of current portion	32,240	14,263
Other non-current liabilities	2,103	1,202
Total liabilities	182,841	128,179
Commitments and contingencies		
Stockholders (deficit) equity:		
Preferred stock, par value \$0.001, 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2014 and 2013		
Common stock, par value \$0.001, 50,000,000 shares authorized, 25,608,937 and 24,495,651 shares issued and outstanding at December 31, 2014 and 2013, respectively	26	24
Additional paid-in capital	223,409	214,487
Accumulated deficit	(266,258)	(203,079)
Total stockholders (deficit) equity	(42,823)	11,432
Total liabilities and stockholders (deficit) equity	\$ 140,018	\$ 139,611

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The accompanying notes are an integral part of the Consolidated Financial Statements.

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**Table of Contents****BENEFITFOCUS, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

(in thousands, except share and per share data)

	Year Ended December 31,		
	2014	2013	2012
Revenue	\$ 137,420	\$ 104,752	\$ 81,739
Cost of revenue	87,470	62,411	44,400
Gross profit	49,950	42,341	37,339
Operating expenses:			
Sales and marketing	48,467	36,072	27,905
Research and development	41,729	23,532	14,621
General and administrative	18,657	10,974	7,494
Change in fair value of contingent consideration		(43)	121
Total operating expenses	108,853	70,535	50,141
Loss from operations	(58,903)	(28,194)	(12,802)
Other income (expense):			
Interest income	77	46	53
Interest expense on building lease financing obligations	(3,624)	(1,768)	(1,774)
Interest expense on other borrowings	(682)	(381)	(202)
Other expense	(22)	(95)	(64)
Total other expense, net	(4,251)	(2,198)	(1,987)
Loss before income taxes	(63,154)	(30,392)	(14,789)
Income tax expense (benefit)	25	(31)	84
Net loss	\$ (63,179)	\$ (30,361)	\$ (14,873)
Comprehensive loss	\$ (63,179)	\$ (30,361)	\$ (14,873)
Net loss per common share:			
Basic and diluted	\$ (2.51)	\$ (2.99)	\$ (3.09)
Weighted-average common shares outstanding:			
Basic and diluted	25,207,099	10,144,243	4,812,632

The accompanying notes are an integral part of the Consolidated Financial Statements.

**Table of Contents****BENEFITFOCUS, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS (DEFICIT) EQUITY**

(in thousands, except share data)

	Common Stock, No Par Value		Common Stock, \$0.001 Par Value		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders (Deficit) Equity
	Shares	Par Value	Shares	Par Value			
Balance, December 31, 2011	4,805,957	\$ 4,923		\$	\$	\$ (157,368)	\$ (152,445)
Exercise of stock options	50,410	108					108
Repurchase of common stock	(64,020)	(122)				(477)	(599)
Stock-based compensation expense		712					712
Accretion of customer warrant		488					488
Net loss						(14,873)	(14,873)
Balance, December 31, 2012	4,792,347	\$ 6,109		\$	\$	\$ (172,718)	\$ (166,609)
Exercise of stock options	71,694	168	129,750		531		699
Issuance of common stock	5,000	68					68
Effects of corporate restructuring	(4,869,041)	(7,328)	4,869,041	5	7,323		
Initial public offering, net of issuance costs			3,000,000	3	70,061		70,064
Conversion of redeemable convertible preferred stock			16,496,860	16	135,461		135,477
Stock-based compensation expense		537			665		1,202
Accretion of customer warrant		446			446		892
Net loss						(30,361)	(30,361)
Balance, December 31, 2013		\$	24,495,651	\$ 24	\$ 214,487	\$ (203,079)	\$ 11,432
Exercise of stock options			642,152	1	2,817		2,818
Issuance of common stock upon vesting of restricted stock units, net of shares surrendered for taxes			15,613		(226)		(226)
Issuance of common stock for cashless exercise of warrant			455,521	1	(1)		
Stock-based compensation expense					5,588		5,588
Accretion of customer warrant					744		744
Net loss						(63,179)	(63,179)
Balance, December 31, 2014		\$	25,608,937	\$ 26	\$ 223,409	\$ (266,258)	\$ (42,823)

The accompanying notes are an integral part of the Consolidated Financial Statements.

**Table of Contents****BENEFITFOCUS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Year Ended December 31,				
	2014	2013	2012		
<b>Cash flows from operating activities</b>					
Net loss	\$ (63,179)	\$ (30,361)	\$ (14,873)		
Adjustments to reconcile net loss to net cash and cash equivalents (used in) provided by operating activities:					
Depreciation and amortization	9,493	8,172	8,560		
Stock-based compensation expense	5,588	1,202	712		
Change in fair value and accretion of warrant	744	892	488		
Interest accrual on financing obligation	3,624	1,768	1,774		
Change in fair value of contingent consideration		(17)	188		
Provision for doubtful accounts		(32)	98		
Loss on disposal or impairment of property and equipment	25				
	<b>September 23, 2003(a)</b>	<b>Revenue</b>	<b>September 30, 2004</b>	<b>Revenue</b>	
	<b>(Thousands of dollars)</b>				
Revenues	\$ 135,080	100.0 %	\$ 164,209	100.0 %	
Gross profit	21,572	16.0 %	25,974	15.8 %	
Selling, general and administrative expenses	25,864	19.1 %	16,197	9.9 %	
Merger related costs		0.0 %	(334 )	-0.2 %	
Provision of uncollectible accounts	193	0.1 %	104	0.1 %	
Amortization of intangible assets	500	0.4 %	2,420	1.5 %	
Income (loss) from operations	(4,985 )	-3.7 %	7,587	4.6 %	
Interest income	415	0.3 %	228	0.1 %	
Interest expense and amortization of debt discount	(3,219 )	-2.4 %	(1,969 )	-1.2 %	
Other income (expense)	(3,426 )	-2.5 %	955	0.6 %	
Income (loss) before income taxes	(11,215 )	-8.3 %	6,801	4.1 %	
Income tax expense (benefit)	(2,913 )	-2.2 %	2,760	1.7 %	
Income (loss) from continuing operations	\$ (8,302 )	-6.1 %	\$ 4,041	2.5 %	

(a) Pro forma for the effects of the Merger which amounts exclude merger-related costs of \$14.3 million.

Revenues: Revenues increased \$29.1 million, or 22%, to \$164.2 million for the 2004 three-month period compared to the Predecessor pro forma 2003 three-month period due primarily to a \$11.8 million increase in aerial electric transmission revenues, including the work performed by Maslonka which we acquired on January 27, 2004, and an increase of \$20.7 million from underground natural gas work,

including approximately \$5.0 million from third quarter acquisitions. Partially offsetting these increases in revenues was a decrease in telecommunications revenue of \$4.8 million. The decrease in telecommunications revenue of \$4.8 million is attributable to the inclusion of \$7.7 million of revenue from OSP, the subsequently discontinued operation, which is included in the Predecessor pro forma 2003 three-month period. Absent this amount, telecommunications revenue increased \$2.9 million.

Gross profit: Gross profit increased \$4.4 million, or 20%, to \$26.0 million in the 2004 three-month period as compared to the Predecessor pro forma 2003 three-month period due primarily to higher gross profit from our natural gas and telecommunications businesses. These increases in gross profit were partially offset by the absence of gross margins from OSP, which is reflected in discontinued operations for the three-month period ended September 30, 2004.

Selling, general and administrative expenses: Selling, general and administrative expenses decreased \$9.7 million, or 37%, to \$16.2 million in the 2004 three-month period compared to the Predecessor pro forma 2003 three-month period. This decrease is primarily due to an \$8.6 million insurance charge and \$1.2 million of expenses related to OSP included in the Predecessor's pro forma 2003 three-month period. OSP operations are included in discontinued operations for the 2004 three-month period. Overall, these decreases were partially offset by incremental expenses related to the Maslonka, Utili-Trax and EnStructure acquisitions of approximately \$2.5 million.

Merger related costs: In the 2004 three-month period, we recorded a credit to merger related expense of \$0.4 million for retention bonuses accrued at the closing of the Merger which have been determined to benefit future periods. Offsetting this amount, in part, is a charge to expense of \$0.1 million for retention bonuses earned during the current quarter.

Amortization of intangible assets: Amortization of intangible assets increased \$1.9 million, or 384%, to \$2.4 million in the 2004 three-month period compared to \$0.5 million in the Predecessor pro forma 2003 three-month period due to amortization of the intangible assets acquired in the Maslonka acquisition partially offset by lower amortization of intangible assets related to the Merger.

Interest expense and amortization of debt discount: We incurred \$2.0 million of interest expense in the 2004 three-month period, a decrease of \$1.3 million from the Predecessor pro forma 2003 three-month period principally reflecting lower interest expense due to the early extinguishment of the note payable to Exelon during the second quarter of 2004.

Other income (expense), net: Other income (expense) increased by \$4.4 million to an other income, net balance for the 2004 three-month period of \$1.0 million compared to an other expense, net balance of \$3.4 million for the Predecessor's pro forma 2003 three-month period. The increase in other income is primarily due to a \$3.8 million charge for a litigation judgment recorded in the Predecessor pro forma 2003 three-month period and income of \$1.0 million from a key-man life insurance policy included in the 2004 three-month period. The increase in other income, net was partially offset by slight increases in various other miscellaneous expenses.

#### **2004 Nine Month Period Compared to the Predecessor 2003 Nine-month Period.**

Revenues: Revenues increased \$74.0 million, or 19%, to \$456.6 million for the 2004 nine-month period compared to the Predecessor 2003 nine-month period due primarily to a \$74.8 million increase in aerial electric transmission revenues, including the work performed by Maslonka which we acquired on January 27, 2004, and an increase of \$30.3 million from underground natural gas work, including approximately \$5.0 million from third quarter acquisitions. Partially offsetting these increases were declines in revenues of \$10.4 million from other electric work, primarily from independent power producers, \$13.5 million from underground electric transmission work and \$13.2 million of telecommunications. The decrease in telecommunications revenue of \$13.2 million is attributable to the

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inclusion of \$17.6 million of revenue from OSP, the subsequently discontinued operation, which is included in the Predecessor 2003 nine-month period. Absent this amount, telecommunications revenue increased \$4.4 million.

Gross profit: Gross profit increased \$23.1 million, or 44%, to \$75.4 million in the 2004 nine-month period compared to the Predecessor 2003 nine-month period due primarily to an increase in gross profit of \$18.1 million from aerial electric transmission work, including gross profit from work performed by Maslonka, and to a lesser extent higher gross profit from our natural gas and telecommunications businesses (including the impact of lower depreciation expense resulting from changes in estimated lives and bases of certain fixed assets resulting from the merger). These increases in gross profit were partially offset by declines in other electric power gross margins, and the absence of gross margins from OSP, which is reflected in discontinued operations for the nine-month period ended September 30, 2004.

Selling, general and administrative expenses: Selling, general and administrative expenses decreased \$2.3 million, or 5%, to \$47.7 million in the 2004 nine-month period compared to the Predecessor 2003 nine-month period. This decrease is primarily due to an \$8.6 million insurance charge and \$2.8 million of expenses related to OSP included in the Predecessor's 2003 nine-month period. OSP operations are included in discontinued operations for the 2004 nine-month period. Overall, these decreases were partially offset by incremental expenses related to the Maslonka, Utili-Trax and EnStructure acquisitions of approximately \$5.2 million and IPO related expenses of approximately \$2.4 million.

Merger related costs: Merger related costs incurred by the Predecessor in the 2003 nine-month period of \$16.2 million, include severance costs, retention costs and professional services fees. In the 2004 nine-month period, we recorded a credit to merger related expense of \$0.4 million for retention bonuses accrued at the closing of the Merger which have been determined to benefit future periods. Offsetting this amount, in part, is a charge to expense of \$0.1 million for retention bonuses earned during the current quarter.

Provision (recoveries) of uncollectible accounts: During the 2004 nine-month period, we recorded recoveries of \$0.4 million related to settlements with customers whose balances had been provided for with an allowance.

Amortization of intangible assets: Amortization of intangible assets was \$11.0 million in the 2004 nine-month period compared with no such amortization in the Predecessor 2003 nine-month period as a result of the amortization of intangible assets acquired in the Maslonka acquisition and the Merger.

Interest expense and amortization of debt discount: We incurred \$8.2 million of interest expense in the 2004 nine-month period reflecting interest on debt resulting from the Merger.

Loss on early extinguishment of debt: In the second quarter of 2004, we recorded a charge of \$5.7 million related to the early extinguishment of the note payable to Exelon. During the third quarter of 2004, \$0.1 million of this charge allocated to ULMS was reclassified to discontinued operations.

Other income (expense), net: Other income (expense) increased by \$4.7 million to an other income, net balance for the 2004 nine-month period of \$1.1 million compared to an other expense, net balance of \$3.6 million for the Predecessor's 2003 nine-month period. The increase in other income is primarily due to a \$3.8 million charge for a litigation judgment recorded in the Predecessor 2003 nine-month period and income of \$1.0 million from a key-man life insurance policy included in the 2004 nine-month period. The increase in other income, net was partially offset by slight increases in various other miscellaneous expenses.



**2004 Nine-Month Period Compared to the Predecessor Pro Forma 2003 Nine-Month Period.**

	Predecessor Pro Forma Nine Months Ended September 23, 2003(a) (Thousands of dollars)	% of Revenue		Nine Months Ended September 30, 2004	% of Revenue
Revenues	\$ 382,627	100.0 %		\$ 456,622	100.0 %
Gross profit	56,847	14.9 %		75,449	16.5 %
Selling, general and administrative expenses	50,062	13.1 %		47,747	10.5 %
Merger related costs		0.0 %		(334 )	-0.1 %
Provision (recoveries) of uncollectible accounts	236	0.1 %		(367 )	-0.1 %
Amortization of intangible assets	3,600	0.9 %		10,989	2.4 %
Income from operations	2,949	0.8 %		17,414	3.8 %
Interest income	1,376	0.4 %		350	0.1 %
Interest expense and amortization of debt discount	(9,298 )	-2.4 %		(8,161 )	-1.8 %
Loss on early extinguishment of debt		0.0 %		(5,549 )	-1.2 %
Other income (expense)	(3,556 )	-0.9 %		1,126	0.2 %
Income (loss) before income taxes	(8,529 )	-2.2 %		5,180	1.1 %
Income tax expense (benefit)	(1,996 )	-0.5 %		2,072	0.5 %
Income (loss) from continuing operations	\$ (6,533 )	-1.7 %		\$ 3,108	0.7 %

(a) Pro forma for the effects of the Merger which amounts exclude merger-related costs of \$16.2 million.

Revenues: Revenues increased \$74.0 million, or 19%, to \$456.6 million for the 2004 nine-month period compared to the Predecessor pro forma 2003 nine-month period due primarily to a \$74.8 million increase in aerial electric transmission revenues, including the work performed by Maslonka which we acquired on January 27, 2004, and an increase of \$30.3 million from underground natural gas work, including approximately \$5.0 million from third quarter acquisitions. Partially offsetting these increases were declines in revenues of \$10.4 million from other electric work, primarily from independent power producers, \$13.5 million from underground electric transmission work and \$13.2 million of telecommunications. The decrease in telecommunications revenue of \$13.2 million is attributable to the inclusion of \$17.6 million of revenue from OSP, the subsequently discontinued operation, which is included in the Predecessor pro forma 2003 nine-month period. Absent this amount, telecommunications revenue increased \$4.4 million.

Gross profit: Gross profit increased \$18.6 million, or 33%, to \$75.4 million in the 2004 nine-month period compared to the Predecessor pro forma 2003 nine-month period due primarily to an increase in gross profit of \$18.1 million from aerial electric transmission work, including gross profit from work performed by Maslonka, and to a lesser extent higher gross profit from our natural gas and telecommunications business. These increases in gross profit were partially offset by declines in other electric power gross margins and the absence of gross margins from OSP, which is reflected in discontinued operations for the nine-month period ended September 30, 2004.

Selling, general and administrative expenses: Selling, general and administrative expenses decreased \$2.3 million, or 5%, to \$47.7 million in the 2004 nine-month period compared to the Predecessor pro forma 2003 nine-month period. This decrease is primarily due to an \$8.6 million insurance charge and \$2.8

million of expenses related to OSP included in the Predecessor's pro forma 2003 nine-month period. OSP operations are included in discontinued operations for the 2004 nine-month period. Overall, these decreases were partially offset by incremental expenses related to the Maslonka, Utili-Trax and EnStructure acquisitions of approximately \$5.2 million and IPO related expenses of approximately \$2.4 million.

Merger related costs: In the 2004 nine-month period, we recorded a credit to merger related expense of \$0.4 million for retention bonuses accrued at the closing of the Merger which have been determined to benefit future periods. Offsetting this amount, in part, is a charge to expense of \$0.1 million for retention bonuses earned during the current quarter.

Provision (recoveries) of uncollectible accounts: During the 2004 nine-month period, we recorded recoveries of \$0.4 million related to settlements with customers whose balances had been provided for with an allowance.

Amortization of intangible assets: Amortization of intangible assets increased \$7.4 million, or 205%, to \$11.0 million in the 2004 nine-month period compared to \$3.6 million in the Predecessor pro forma 2003 nine-month period. This increase is due to amortization of intangible assets acquired in the Maslonka acquisition, partially offset by lower amortization of Merger-related intangible assets in the 2004 nine-month period.

Interest expense and amortization of debt discount: We incurred \$8.2 million of interest expense in the 2004 nine-month period, a decrease of \$1.1 million from the Predecessor pro forma 2003 nine-month period, principally reflecting our debt reduction during the 2004 nine month period.

Loss on early extinguishment of debt: In the second quarter of 2004, we recorded a charge of \$5.7 million related to the early extinguishment of the note payable to Exelon. During the third quarter of 2003, \$0.1 million of this charge allocated to ULMS was reclassified to discontinued operations.

Other income (expense), net: Other income (expense) increased by \$4.7 million to an other income, net balance for the 2004 nine-month period of \$1.1 million compared to an other expense, net balance of \$3.6 million for the Predecessor's pro forma 2003 nine-month period. The increase in other income is primarily due to a \$3.8 million charge for a litigation judgment recorded in the Predecessor pro forma 2003 nine-month period and income of \$1.0 million from a key-man life insurance policy included in the 2004 nine-month period. The increase in other income, net was partially offset by slight increases in various other miscellaneous expenses.

### **Liquidity and Capital Resources**

As of September 30, 2004, we had cash and cash equivalents of \$6.7 million, working capital of \$91.5 million and long-term debt of \$85.1 million principally consisting of term loans under our amended and restated credit agreement. As of September 30, 2004, we had \$4.0 million in borrowings under our revolving credit facility and \$28.1 million in letters of credit outstanding thereunder, leaving \$39.9 million as of that date available for additional borrowings. As of November 10, 2004, our borrowings under the revolving credit facility were \$4.0 million.

On January 22, 2004, we amended our then-existing senior credit facility to permit the acquisition of Maslonka and to obtain additional liquidity and operating flexibility, including expanding our capacity for making capital expenditures. As a result of the amendment, the commitment of the banks under the revolving credit facility was increased by \$10.0 million to \$50.0 million, and the amount available for letters of credit was increased by \$10.0 million to \$35.0 million. Concurrent with the IPO, in order to provide for additional borrowing flexibility and to reduce our borrowing rates to reflect our improved financial position, we entered into an amended and restated credit agreement to, among other things, provide for a revolving credit facility in the original amount of \$40.0 million that could be increased to \$85.0 million and

to provide for a term loan facility in the initial amount of \$85.3 million, which represented the amount of term loans outstanding under the former senior credit facility at May 12, 2004 after giving effect to the mandatory prepayment of \$50.2 million of such loans required in connection with the IPO. As of July 31, 2004, the revolving credit facility had been increased to the full \$85.0 million. A portion of the revolving credit facility not in excess of 80% of the amount thereof may be used for issuances of letters of credit. Term loans and revolving loans under the amended and restated credit agreement initially bear interest, at our option, at the bank's prime interest rate plus a spread of 2.00% or LIBOR plus a spread of 3.00%. Beginning in 2005, such interest rate spreads will be dependent upon our Consolidated Leverage Ratio, as defined in the amended and restated credit agreement, and range from 1.50% to 3.50% for revolving loans and 1.75% to 3.00% for term loans.

Our amended and restated credit agreement contains certain restrictive covenants, including minimum levels of net worth, interest coverage, fixed charge coverage and leverage ratios, among other restrictions. As of September 30, 2004, we were in compliance with all terms and conditions of the amended and restated credit agreement.

Our working capital needs are influenced by the seasonality of our business. We experience a need for additional working capital during the spring when we increase our level of outdoor construction in weather-affected regions of the country. Conversely, we convert working capital assets to cash during the winter months.

We expect capital expenditures to range from \$5.0 million to \$7.0 million during the remainder of 2004. We intend to fund those expenditures primarily from operating cash flow. We have reduced our capital expenditures over the past two years in order to increase the utilization rates of our equipment.

As of October 1, 2004, we increased our stop loss deductible from \$0.5 million per accident or occurrence to \$0.75 million for workers compensation, employer's liability and general liability insurance claims. Losses up to the stop loss amounts are accrued based upon our estimates of the ultimate liability for claims incurred and an estimate of claims incurred but not reported. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate. In addition claims covered by the insurance carrier are accrued, with corresponding receivable amounts in our condensed consolidated balance sheet.

During the third quarter of 2004, we completed two acquisitions using approximately \$24.6 million of cash. Funding for these acquisitions was primarily from operations, borrowings under our revolving credit facility of \$4.0 million, the cash payment from Exelon of \$7.7 million from the purchase price adjustment related to the Merger, and cash proceeds of \$8.4 million from the sale of RJE assets.

During the nine months ended September 30, 2004, our contract receivables, including contract receivables due from related parties, and costs and estimated earnings in excess of billings, net of billings in excess of costs and estimated earnings have increased 17% and 165%, respectively. The overall increase was due to increased revenues in 2004, as well as the seasonal effect of increased work during the summer and fall months. A significant portion of the increases are also related to our two largest customers, Exelon and WAPA.

Included in costs and estimated earnings in excess of billings are costs related to claims of approximately \$3.3 million and \$0 at September 30, 2004 and December 31, 2003, respectively. The claim amounts are primarily related to a delay in the anticipated start date of one of our electric transmission contracts. Costs incurred that are attributable to claims are included in the total estimated revenue when realization is probable and amounts are estimable. Profit from claims is recorded in the period such amounts are agreed to with the customer.

We anticipate that our cash flow from operations, cash on hand, and our amended and restated credit facility will provide sufficient cash to enable us to meet our working capital needs, debt service requirements and planned capital expenditures for property and equipment over the next twelve to eighteen months. However, deterioration in the markets we serve, material changes in our customers' businesses or cash flows or adverse weather conditions could negatively impact our revenues and cash flows. These factors, coupled with restrictive covenants under our amended and restated credit agreement, may negatively impact our ability to meet these needs.

*Cash from operating activities from continuing operations.* During the 2004 nine-month period, net cash used by operating activities from continuing operations was \$0.9 million compared to net cash provided by operating activities from continuing operations of \$17.8 million for the Predecessor 2003 nine-month period. The principal uses of operating cash during the 2004 nine-month period were payments for labor and materials related to performance of services and selling, general and administrative expenses. Changes in operating assets and liabilities during the 2004 nine-month period used \$25.3 million of operating cash flow from continuing operations, while in the Predecessor 2003 nine-month period changes in operating assets and liabilities provided \$15.3 million in operating cash flow. The greater use of cash from changes in operating assets and liabilities from continuing operations for the 2004 nine-month period is primarily due to a \$9.8 million use in other current and accrued liabilities for payments of income taxes and employee bonus and retention payments as compared to the Predecessor 2003 nine-month period increase of \$13.2 million in other current and accrued liabilities balance; and an increase of \$24.6 million in the 2004 nine-month period compared to the Predecessor 2003 nine-month period for contract receivables, net, contract receivables due from related parties, net, and costs and estimated earnings in excess of billings, net. Additionally, amounts due from affiliates were reduced from the Predecessor 2003 nine-month period as a result of payments received in the prior year of \$9.6 million.

*Cash from investing activities from continuing operations.* During the 2004 nine-month period, net cash used by investing activities from continuing operations was \$55.1 million compared to cash used by investing activities from continuing operations of \$12.5 million for the Predecessor 2003 nine-month period. The primary uses of cash for the 2004 nine-month period were cash payments for the acquisitions of Maslonka, Utili-Trax and EnStructure, net of cash acquired, of \$49.6 million, and purchases of equipment of \$17.5 million, offset in part, by cash proceeds from the sale of equipment of \$3.3 million and the sale of OSP of \$8.6 million. The principal use of cash during the Predecessor 2003 nine-month period consisted of purchases of equipment of \$16.4 million, offset in part by \$3.8 million in cash proceeds from sales of equipment.

*Cash from financing activities from continuing operations.* During the 2004 nine-month period, net cash provided by financing activities from continuing operations was \$49.6 million compared to net cash used in financing activities from continuing operations of \$10.2 million for the Predecessor 2003 nine-month period. The primary sources of cash from financing activities for the 2004 nine-month period of \$130.3 million consisted of \$29.5 million of proceeds from the issuance of our common stock to the Principal Shareholders and certain members of management in conjunction with the acquisition of Maslonka and \$100.8 million of net cash from our initial public offering, which occurred on May 12, 2004. The proceeds from the issuance of our common stock were used to repay \$50.2 million of our term loan, \$30.0 million to repay the principal amount outstanding of our subordinated note with Exelon and the remaining \$20.6 million retained for general corporate purposes. The prior year period use of \$10.2 million consisted primarily of purchases of treasury stock and redemption of redeemable stock.

**Contractual Obligations and Other Commitments**

The following table represents contractual obligations and other commitments as of September 30, 2004.

Current and Long-Term Debt	Payments due by Period						Total
	2004	2005	2006	2007	2008	Thereafter	
	(in thousands)						
Senior credit facility	\$ 213	\$ 853	\$ 853	\$ 853	\$ 853	\$ 81,258	\$ 84,883
Revolving credit facility	4,000						4,000
Long-term debt related party			1,000				1,000
Bank notes	34	69					103
Other	97						97
Total	\$ 4,344	\$ 922	\$ 1,853	\$ 853	\$ 853	\$ 81,258	\$ 90,083

Other Contractual Obligations(1)	Payments due by Period						Total
	2004	2005	2006	2007	2008	Thereafter	
	(in thousands)						
Other long-term liabilities:							
Contingent earnout	\$	\$	\$ 5,009	\$	\$	\$	\$ 5,009
Non-vested options exercised	69	512	512	513			1,606
Other		374					374
Total	\$ 69	\$ 886	\$ 5,521	\$ 513	\$	\$	\$ 6,989

(1) Trade accounts payable are not included in Contractual Obligations.

Other Commercial Commitments	Amount of Commitment Expiration Per Period						Total
	2004	2005	2006	2007	2008	Thereafter	
	(in thousands)						
Operating leases	\$ 1,587	\$ 6,055	\$ 5,574	\$ 3,777	\$ 1,915	\$ 1,064	\$ 19,972

As of September 30, 2004, future cash requirements for interest payments on our senior credit facility are as follows:

Period	In Thousands
2004	\$ 1,129
2005	4,489
2006	4,444
2007	4,399
2008	4,353
2009	4,308
2010	3,201

In accordance with the holdback provisions of the acquisition agreement to acquire Maslonka, we are holding back purchase price consideration in the amount of \$6.6 million from certain of Maslonka's former shareholders. Of this amount, \$5.5 million is contingent upon Maslonka's achievement of certain performance targets as well as the satisfaction of any indemnification obligations owed to us, which may also be set-off against all other portions of the holdback. We expect that the holdback amount, less any amounts retained by us, will be released to the sellers in part in 2005 and the remainder in 2006.

**Related Party Transactions**

On October 6, 1999, the InfraSource Group entered into a services agreement ( Services Agreement ) with Exelon for Exelon to provide certain services, including contracting for employees, financial and accounting services, payroll services, office and equipment leases and other administrative



and support services. The scope of these services was reduced each year of the agreement. This agreement was effective for a period of 12 months commencing in October of each year and was renewable at both parties' discretion. The InfraSource Group, through InfraSource Corporate Services, Inc., was charged \$0.3 million and \$1.2 million for these services for the Predecessor periods June 21, 2003 to September 23, 2003 and January 1, 2003 to September 23, 2003, respectively. Pursuant to the Merger, this Services Agreement was terminated.

The InfraSource Group has several service contracts with Exelon and performs various services including utility construction and maintenance, telecommunications and infrastructure services on an outsourced basis to business and residential customers. Certain operating assets and liabilities of the Non-Acquired Group, including certain operating agreements (the "Operating Agreements") with Exelon, were transferred to the InfraSource Group as of January 1, 2003, with operating results related to the Operating Agreements reflected in the accompanying consolidated statement of operations beginning with the date of transfer. Under the Operating Agreements, we perform infrastructure services on an outsourced basis to business and residential customers. Each Operating Agreement has an annual term ending on December 31 which automatically renews each year unless formally terminated by Exelon. The services were provided to Exelon at a rate that is intended to approximate market value. Revenues charged to Exelon under these contracts for the Predecessor periods June 21, 2003 to September 23, 2003 and January 1, 2003 to September 23, 2003 were \$10.9 million and \$25.0 million, respectively. These Operating Agreements remained in place following the Merger. On January 29, 2004, Exelon relinquished its sole seat on our Board of Directors and ceased to be a related party at that time. Revenues from Exelon for the period January 1 through January 29, 2004 (the date it ceased to be a related party) were \$7.6 million.

In addition to the Operating Agreements, revenues for the Predecessor periods June 21, 2003 to September 23, 2003 and January 1, 2003 to September 23, 2003 related to contracts with Exelon were \$10.9 million and \$28.5 million, respectively. Accounts receivable related to all revenues due from Exelon were \$14.6 million at December 31, 2003.

In March 2004, after receiving approval from the required parties, we distributed \$7.2 million of property and equipment that pursuant to the original terms of a purchase agreement with Blair Park were owed to three officers of Blair Park. The corresponding liability related to these assets is reflected in other liabilities related parties in the December 31, 2003 condensed consolidated balance sheet. Additionally, we lease office and warehouse space from Coleman Properties of which three officers of Blair Park are general partners. Our annual lease payments are approximately \$0.1 million.

We lease office and warehouse facilities in Michigan which are owned by an employee and his family members. Our leases for these facilities will run through February 2005, subject to a four-year renewal option. Pursuant to these leases, we expect to incur total annual lease payments of \$0.3 million.

In connection with the Maslonka acquisition, our Principal Stockholders secured the issuance of \$10.0 million worth of letters of credit. These letters of credit were provided as credit support to enable Maslonka to secure a performance bond on a new project award. After consummation of the Maslonka acquisition, we caused the letters of credit to be terminated. We paid an aggregate fee of \$0.2 million to the Principal Stockholders for providing this security.

We lease our Maslonka headquarters in Mesa, Arizona and our Maslonka Texas field office in San Angelo, Texas from EC Source, LLC, which is wholly-owned by Martin Maslonka, one of our shareholders. Our leases for these two properties will run through February 2009, subject to a five-year renewal option. Pursuant to these leases, we expect to incur total annual lease payments of \$0.2 million.

Maslonka is the issuer of a \$1.0 million installment promissory note in favor of Martin Maslonka. The promissory note bears interest at an annual rate of 8.5%, and interest is payable in equal monthly payments of \$7,000. The promissory note matures on June 30, 2006.

We sublease two equipment yards, which are owned by one of our employees, from a subsidiary of SEMCO Energy Inc. Pursuant to six-month subleases through February 2005, we will incur aggregate lease payments of \$0.1 million.

### **Risks Relating to Our Business and Industry**

#### **Demand for our services is cyclical and vulnerable to downturns in the industries we serve, which may result in extended periods of low demand for our services.**

The demand for infrastructure services in the industries we serve has been, and will likely continue to be, cyclical in nature and vulnerable to general downturns in the U.S. economy. A number of other factors, including financial conditions in the industries we serve, could adversely affect our customers and their ability or willingness to fund capital expenditures in the future. For example, we have experienced reductions in our revenues from independent power producers in 2003 and through the first half of 2004, which reflects the significant decline in construction activity and new construction awards for power generation projects. The demand for our services to natural gas distribution customers is affected by the level of new housing construction. In addition, our petrochemical customers' demand has recently been restrained by the impact of high natural gas prices. We are also dependent on the amount of infrastructure services that our customers outsource. During downturns in the economy, our customers may determine to outsource fewer projects resulting in decreased demand for our services. In addition, the historical trend toward outsourcing of infrastructure services may not continue as we expect. As a result, demand for our services could substantially decline for extended periods, particularly during economic downturns.

#### **The award of new contracts and the timing of these awards may result in unpredictable fluctuations in our cash flow and profitability.**

A substantial portion of our revenues is derived from project-based work. It is generally very difficult to predict whether and when we will be awarded contracts for these projects, resulting in unpredictability in our cash flow and profitability. We expect to have a higher percentage of revenues from large-scale projects going forward, further exacerbating the unpredictability of our operating results. For example, Maslonka's transmission line portion of the Path 15 project is an approximately \$88 million contract that will be performed primarily in 2004. There can be no assurance that we will be awarded contracts for other projects to replace the revenues generated from the Path 15 contract.

In addition, some of our contracts are subject to financing and other contingencies that may delay or result in termination of projects. In certain circumstances, customers may require us to provide credit enhancements, including surety bonds, letters of credit and, in rare instances, cash collateral, which we may be unable to satisfactorily obtain or provide, placing us at a competitive disadvantage compared to providers with more liquidity. The uncertainty of our contract award timing can also present difficulties in matching workforce size with contract needs. In some cases, we maintain and bear the cost of a ready workforce that is larger than necessary in anticipation of future workforce needs for expected contract awards. If an expected contract award is delayed or not received, we could incur costs that could be substantial without receipt of any corresponding revenues.

#### **We derive a significant portion of our revenue from a small group of customers. The loss of one or more of these customers could negatively impact our revenues.**

Our top ten customers accounted for approximately 48% and 49% of our revenues during 2003 and the nine month period ended September 30, 2004, respectively, which includes work performed for those customers as a subcontractor through others. Sales to Exelon accounted for 16.0% of our revenues during 2003. In September 2003, we entered into a volume agreement with Exelon, pursuant to which we are assured a continuing level of business from Exelon through 2006 at approximately the same levels as in 2003, subject to earlier termination under limited circumstances. Revenue under the contract may vary



significantly from period-to-period and may be concentrated later in the contract period. We may be unable to sustain our volume of business with Exelon after expiration of the contract.

In May 2003, Maslonka was awarded an approximately \$88 million transmission line contract, relating to the Path 15 upgrade project, scheduled to be substantially completed in 2004. The Western Area Power Authority, which manages the Path 15 project, is one of our key customers in 2004. We may not be able to replace this contract after its completion.

**The anticipated investment in electric infrastructure may not be as large as expected, which could reduce demand for our services or slow our growth.**

Our business strategy is dependent, in part, upon the expected increased investment in the electric power grid, which may not materialize. This expected increase is based, in part, upon prospects for passage of certain Federal energy legislation and incentive based ratemaking initiatives being considered by FERC. There is considerable uncertainty as to when or whether the United States Congress will pass comprehensive Federal energy legislation as proposed in 2003, or whether it will enact any other form of energy legislation that would improve the prospects for increased investment in energy infrastructure. Even if Federal energy legislation is passed, the provisions may not incentivize increased investments in electric power transmission infrastructure in a manner that will increase demand for our services. In addition, it is uncertain whether FERC will establish incentive-based ratemaking for all interstate transmission under the control of regional transmission operators. Continued uncertainty may result in decreased demand or slower growth in demand for our services.

**Seasonal and other variations may cause significant fluctuations in our cash flows and profitability, which may cause the market price of our common stock to fall in certain periods.**

Due to the fact that a significant portion of our business is performed outdoors, our results of operations are subject to seasonal variations. Less work is performed by us in the winter months and work is hindered during other inclement weather events. Our profitability often decreases during the winter months and during severe weather conditions because work performed during these periods is more costly to complete. For example, in the first half of 2003, severe cold and wet conditions increased the cost and reduced the profitability of many of our subsurface construction projects. Similar wet conditions were experienced during the second and third quarters of 2004. In addition, during periods of peak electricity demand, utilities generally are unable to remove their electric power transmission and distribution equipment from service, decreasing the demand for our maintenance services during this period. If our operating results fall below the public's or analysts' expectations in some future period or periods, the market price of our common stock will likely fall in such period or periods.

**Our dependence upon fixed-price contracts could result in reduced profitability or losses on projects.**

We currently generate, and expect to continue to generate, the majority of our revenues under fixed-price contracts. Under fixed-price contracts, we agree to perform the entire project for a fixed price on an agreed upon schedule. We may be unable to recover any cost overruns to the approved contract price. We have experienced delays and additional costs that we have been unable to recover resulting from severe weather conditions and the required replacement of defective materials from a third party that we installed. As a result, our actual revenue and gross profits for a project may differ from those we originally estimated and could result in reduced profitability or losses on projects. Depending on the size of a particular project, variations from the estimated contract costs can have a significant impact on our operating results for any fiscal quarter or year. We expect that industry trends and our acquisition of Maslonka will result in an increase in the proportion of our fixed-price contracts, as most of Maslonka's business is performed on a fixed-price basis.

**Our customers often have no obligation to assign work to us and many of our contracts may be terminated on short notice. As a result, we are at risk of losing significant business on short notice.**

Certain of our customers assign work to us under master service agreements. Under these arrangements, our customers generally have no obligation to assign work to us. Most of our contracts, including our master service agreements, may be terminated by our customers on short notice, typically 30 to 90 days, sometimes less. Moreover, our reported backlog includes estimated work to be performed under these agreements, and our reported backlog may not be realized as revenues if these contracts are cancelled. In addition, many of our contracts, including our master service agreements, are open to competitive bidding at the expiration of their terms. As a result, we have been displaced on these contracts by competitors from time to time. Our revenues could materially decline if our customers do not assign work to us or if they cancel a significant number of contracts and we cannot replace them with similar projects.

**Project delays or cancellations may result in additional costs to us, reductions in revenues or the payment of liquidated damages.**

In certain circumstances, we guarantee project completion by a scheduled acceptance date or achievement of certain acceptance and performance testing levels. Failure to meet any of these schedules or performance requirements could result in additional costs or penalties, including liquidated damages, and these amounts could exceed expected project profit margins. Many of our projects involve challenging engineering, procurement and construction phases that may occur over extended time periods, sometimes up to two years. We may encounter difficulties in engineering, equipment and supply delivery, schedule changes, weather-related delays and other factors, some of which are beyond our control, that impact our ability to complete the project in accordance with the original delivery schedule. In addition, we occasionally contract with third-party subcontractors to assist us with the completion of contracts. Any delay by suppliers or by subcontractors in the completion of their portion of the project, or any failure by a subcontractor to satisfactorily complete its portion of the project may result in delays in the overall progress of the project or may cause us to incur additional costs, or both. We also may encounter project delays due to local public opposition against the siting of transmission lines or other facilities, which may include injunctive actions as well as public protests. For example, the construction of the PowerUp Wisconsin transmission line project was delayed for several years due to such factors.

Delays and additional costs may be substantial, and, in some cases we may be required to compensate the project customer for these delays. We may not be able to recover all of these costs. In extreme cases, the above-mentioned factors could cause project cancellations, and we may not be able to replace such projects with similar projects or at all.

In addition, our project contracts may require that our customers or other parties provide us with design or engineering information or with equipment or materials to be used on a project. In some cases, we may be provided with deficient design or engineering information or equipment or provided with information or equipment later than required by the project schedule. Our customers may also determine, after commencement of the project, to change various elements of the project. Under these circumstances, we generally negotiate with the customer with respect to the amount of additional time required and the compensation to be paid to us. We are subject to the risk that we are unable to obtain, through negotiation, arbitration, litigation or otherwise, adequate amounts to compensate us for the additional work or expenses incurred by us due to customer-requested change orders or failure by the customer to timely provide items required to be provided by the customer. A failure to obtain adequate compensation for these matters could require us to record a negative adjustment to amounts of revenue and gross profit that were recognized in prior periods under the percentage of completion accounting method. Any such adjustments could be substantial.

**Skilled labor shortages and increased labor costs could negatively affect our ability to operate efficiently and implement our growth strategy.**

We have from time-to-time experienced shortages of certain types of qualified personnel. For example, there is currently a shortage of linemen capable of working on and supervising the construction of high-voltage lines, and linemen are frequently recruited across geographic regions to satisfy demand. The supply of experienced linemen and supervisors may not be sufficient to meet current or expected demand. Further, we may not be able to allocate or hire sufficient project managers for new electric power transmission projects. As a result, we may not be able to pursue certain projects and we may not be able to maintain an adequate skilled labor force necessary to operate efficiently and support our growth strategy.

**Our use of percentage-of-completion accounting could result in a reduction or elimination of previously reported profits.**

A significant portion of our revenues is recognized on a percentage-of-completion method of accounting, using the cost-to-cost method. This method is used because management considers expended costs to be the best available measure of progress on these contracts. This accounting method is standard for fixed-price contracts. The percentage-of-completion accounting practice we use results in our recognizing contract revenues and earnings ratably over the contract term in proportion to our incurrence of contract costs. The earnings or losses recognized on individual contracts are based on estimates of contract revenues, costs and profitability. Contract losses are recognized in full when determined, and contract profit estimates are adjusted based on ongoing reviews of contract profitability. Further, a substantial portion of our contracts contain various cost and performance incentives. Penalties are recorded when known or finalized, which is generally during the latter stages of the contract. In addition, we record cost recovery claims when we believe recovery is probable and the amounts can be reasonably estimated. Actual collection of claims could differ from estimated amounts and could result in a reduction or elimination of previously recognized earnings. In certain circumstances, it is possible that such adjustments could be significant.

**Provisions of our credit facility restrict our business operations and may restrict our access to sufficient funding, including letters of credit, in the future to finance desired growth.**

We have an amended and restated credit facility with a group of financial institutions secured by substantially all of our assets. The terms of the amended and restated credit facility contain customary events of default and covenants that limit us from taking certain actions without obtaining the consent of the lenders. In addition, our amended and restated credit facility requires us to achieve certain financial ratios. These restrictions and covenants may limit our ability to respond to changing business and economic conditions and we may be prevented from engaging in transactions that might otherwise be considered beneficial to us, including strategic acquisitions. Covenants in our amended and restated credit facility also restrict our ability to incur indebtedness, subject to certain exceptions, including domestic intercompany indebtedness, guarantee obligations incurred in the ordinary course of business, up to \$20.0 million of secured indebtedness incurred to acquire fixed or capital assets, indebtedness in respect of performance bonds, letters of credit and similar obligations incurred in the ordinary course of business, and up to \$20.0 million of additional indebtedness. We had \$52.9 million of availability under our secured revolving credit facility as of September 30, 2004 (after giving effect to \$28.1 million of outstanding letters of credit and \$4.0 million in borrowings under the revolving credit facility at that date).

Our business also frequently requires us to post letters of credit, which reduces availability under our revolving credit facility. If we are required to post letters of credit in excess of the \$68 million sublimit in effect as of September 30, 2004 under our amended and restated credit facility, we would be required either to increase this sublimit or cash collateralize the letters of credit. We cannot assure you that we

would be able to increase the sublimit under our credit facility or that we would have sufficient cash to obtain the required letters of credit.

A breach of our amended and restated credit agreement, including our inability to comply with the required financial ratios, could result in a default under our amended and restated credit facility. In the event of any default under our amended and restated credit facility, the lenders thereunder would be entitled to accelerate the repayment of amounts outstanding, plus accrued and unpaid interest. Moreover, these lenders would have the option to terminate any obligation to make further extensions of credit under our credit facility. In the event of a default under any of our secured indebtedness, including our credit facility which is secured by substantially all of our assets, the lenders thereunder could proceed to foreclose against the assets securing such obligations. In the event of a foreclosure on all or substantially all of our assets, we may not be able to continue to operate as a going concern.

**If we are unsuccessful at integrating companies that we acquire or have acquired, we may not achieve the expected benefits and our profitability could suffer.**

One of our business strategies is to pursue highly strategic acquisitions. We have completed several acquisitions and plan to continue to consider strategic acquisitions now and in the future. Integrating acquisitions is often costly, and delays or other operational or financial problems may result that interfere with our operations. In addition, our operating subsidiaries have generally maintained their own procedures and operating systems, which makes it more difficult for us to evaluate and integrate their systems and controls on a reliable company-wide basis. We have, however, imposed or are imposing specific company-wide requirements on our operating subsidiaries in a number of areas as we continue the process of integrating our acquired businesses, but these requirements may not be effective. We plan to introduce a company-wide internal audit function in the fourth quarter of 2004 to enhance our controls and procedures, including those necessary for a public company. We may experience difficulties implementing these new company-wide systems. If we fail to implement proper overall business controls, including as required to support our growth, inconsistent operating and financial practices at companies we acquire or have acquired could result.

**A significant portion of our business depends on our ability to provide surety bonds. We may be unable to compete for or work on certain projects if we are not able to obtain the necessary surety bonds.**

Surety market conditions are currently difficult as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more expensive and restrictive. After the Exelon Transaction, we were required to post letters of credit to support a new surety bond program. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis and can decline to issue bonds at any time. Historically, approximately 10% to 20% of our annual volume of business, including a number of our fixed-price contracts, has required bonds. These percentages may increase depending on our mix of contracts. Current or future market conditions, as well as changes in our surety's assessment of our operating and financial risk, could cause our surety providers to decline to issue, or substantially reduce the amount of, bonds for our work and could increase our bonding costs. These actions can be taken on short notice. If our surety providers were to limit or eliminate our access to bonding, our alternatives include seeking bonding capacity from other sureties, finding more business that does not require bonds and posting other forms of collateral for project performance, such as letters of credit or cash. We may be unable to secure these alternatives in a timely manner, on acceptable terms or at all. Accordingly, if we were to experience an interruption or reduction in the availability of bonding capacity, we may be unable to compete for or work on certain projects.

**We are subject to the risks associated with being a government contractor.**

We are a provider of services to government agencies, primarily the U.S. Department of Energy's Federal power marketing agencies, such as the Western Area Power Authority and the Bonneville Power Administration, and therefore are exposed to the risks associated with government contracting. For example, a reduction in spending by these government agencies could limit the continued funding of existing contracts with these agencies and could limit our ability to obtain additional contracts, which could result in lower revenues from these customers. The risks of government contracting also include the risk of civil and criminal fines and penalties for violations of applicable regulations and statutes and the risk of public scrutiny of our performance on high profile sites. In addition, our failure to comply with the terms of one or more of our government contracts, other government agreements, or government regulations and statutes could result in our being suspended or barred from future government contract projects for a significant period of time.

In addition, government customers typically can terminate or modify any of their contracts with us at their convenience, and some of these government contracts are subject to renewal or extension annually. If a government customer terminates a contract or fails to renew or extend a contract, our backlog or revenue may be reduced or we may incur a loss, either of which could impair our financial condition and operating results. A termination due to our unsatisfactory performance could expose us to liability and adversely affect our ability to compete for future contracts and orders. In cases where we might be a subcontractor, the prime contract under which we would be a subcontractor could be terminated, regardless of the quality of our services as a subcontractor or our relationship with the relevant government agency. Our government customers can also reduce the value of existing contracts, issue modifications to a contract, and control and potentially prohibit the export of our services and associated materials.

**Our projects are subject to numerous hazards. If we do not maintain an adequate safety record, we may be ineligible to bid on certain projects, could be terminated from existing projects and could have difficulty procuring adequate insurance.**

Hazards related to our activities include electrocutions, fires, natural gas explosions, mechanical failure, transportation accidents and damage to equipment we work on. These hazards can cause personal injury and loss of life, severe damage to or destruction of property and equipment and other consequential damages, including blackouts, and may result in suspension of operations, large damage claims, and, in extreme cases, criminal liability. At any given time, we are subject to multiple workers' compensation and personal injury claims. We maintain substantial loss accruals for workers' compensation claims, and our workers' compensation and insurance costs have been rising for several years notwithstanding our emphasis on safety. Our insurance does not cover all types or amounts of liabilities. Our third-party insurance is subject to large deductibles for which we establish reserves and, accordingly, we effectively self-insure for much of our exposures. In addition, for a variety of reasons such as increases in claims, a weak economy, projected significant increases in medical costs and wages, lost compensation, and reductions in coverage, insurance carriers may be unwilling to provide the current levels of coverage without a significant increase in collateral requirements to cover our deductible obligations. We may not be able to maintain adequate insurance at reasonable rates or meet collateral requirements. Further, regulatory changes implemented by OSHA could impose additional costs on us. Our safety record is an important consideration for our customers. If serious accidents or fatalities occur or our safety record were to deteriorate, we may be ineligible to bid on certain projects and could be terminated from existing projects. In addition, our reputation and our prospects for future projects could be negatively affected. The OSHA Recordable rate of certain of our subsidiaries has historically been higher than the industry average. If we cannot improve on these subsidiaries' safety records, we may not be able to bid successfully on future projects.

**Our unionized workforce could cause interruptions in our provision of services. In addition, we contribute to multiemployer plans that could result in liabilities to us if these plans are terminated or we withdraw.**

A significant percentage of our workforce is covered by collective bargaining agreements. Strikes or work stoppages could occur that would adversely impact our relationships with our customers and our ability to conduct our business.

In addition, we contribute to several multiemployer pension plans for employees covered by collective bargaining agreements. These plans are not administered by us, and contributions are determined in accordance with provisions of negotiated labor contracts. The Employee Retirement Income Security Act of 1974 ( ERISA ), as amended by the Multiemployer Pension Plan Amendments Act of 1980, imposes certain liabilities upon employers who are contributors to a multiemployer plan in the event of the employer's withdrawal from, or upon termination of, such plan. We do not have information on the net assets and actuarial present value of the multiemployer pension plans' unfunded vested benefits allocable to us, if any, or the amounts, if any, for which we may be contingently liable if we were to withdraw from any of these plans.

**If Congress or the FCC changes the law or regulations that provide subsidies for telecommunications services to schools, libraries, and certain health-care facilities, demand for some of our telecommunications services could decrease substantially. Furthermore, additional regulation of our telecommunications services could reduce the profitability of those services.**

Many of our telecommunications customers benefit from the Universal Service E-rate program, which was set-up by Congress in the 1996 Telecommunications Act and is administered by the Universal Service Administrative Company ( USAC ) under the oversight of the Federal Communications Commission ( FCC ). To remain eligible to provide services under this program in any state, we must maintain our telecommunications authorizations in that state. Under the E-rate program, schools, libraries and certain health-care facilities may receive subsidies for certain approved telecommunications services, internet access, and internal connections. From time to time, bills have been introduced in Congress that would eliminate or curtail the E-rate program. If such a bill were passed, or if the FCC or USAC were to further limit E-rate subsidies, it could result in a decrease in the demand for our telecommunications infrastructure services by certain customers.

It is our position that the telecommunications services that we provide wholly within a particular state are subject to regulation exclusively by such state. Thus, except for a few facilities that we offer across state lines, we believe that our telecommunications-related services are not subject to regulation by the FCC as interstate telecommunications services. It is possible that the FCC may take the position, as a result of an interpretation of existing regulations and/or a change to such regulations, that some of our services are subject to FCC regulation as interstate telecommunications services. We may also expand our service offerings to include activities that are definitely subject to FCC regulation. To the extent that we are subject to FCC regulation for interstate telecommunications services, we would be required to make certain filings and revenue-based contributions related to the federal Universal Service Fund, which could reduce the profitability of our telecommunications business. We could also be subject to fines if the FCC were to determine that any of our activities or positions violated its regulations.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risks results primarily from adverse changes in interest rates. We have not historically used derivative instruments for trading purposes or to speculate on changes in interest rates or commodity prices.

In October 2003, we entered into an interest rate swap agreement and an interest rate cap agreement with terms of three years, both of which qualify and have been designated as cash flow hedges to reduce market interest rate risk associated with \$70 million notional amount of our variable rate term loan. After considering the effect of these agreements, a portion of our long-term debt obligations remain subject to interest rate risk. The annual detrimental net income effect of a 50 basis point increase in interest rates on these long-term obligations, after considering the \$50.2 million reduction in our term loan concurrent with the IPO, would be less than \$0.1 million.

**Item 4. Controls and Procedures**

**(a) Evaluation of Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report were designed and functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

**(b) Change in Internal Control over Financial Reporting**

No change in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On February 7, 2003, RaHSanne Bickman filed suit in the Travis County District Court in Texas State Court against Maslonka and one employee alleging, among other things, gross negligence and seeking approximately \$24 million in actual and compensatory damages arising out of the death of her son. On October 27, 2003, the father of the deceased, Kevin Sam, Sr., filed suit in Taylor County Texas District Court seeking unspecified damages. The claims arose out of an automobile accident that took place on December 1, 2002 on an interstate highway in Texas and resulted in death. In February 2004, RaHSanne Bickman's claims were resolved through an out of court settlement fully funded by insurance proceeds (less a \$10,000 deductible). The dismissal order was entered on March 25, 2004. The claims of Kevin Sam, Sr. have been docketed for trial on December 13, 2004.

In January 2004, a judgment was entered against InfraSource in Superior Court of Fulton County, Georgia in the amount of \$3.8 million, including \$3.2 million in punitive damages. The jury verdict upheld allegations by the plaintiff that in 1999 InfraSource Incorporated (formerly known as Exelon Infrastructure Services, Inc.) had fraudulently induced the plaintiff to incur expenses in connection with a proposed business acquisition that was never consummated. We filed a notice of appeal on February 19, 2004, and the plaintiff filed a notice of cross-appeal on March 2, 2004. Pursuant to the appellate court's May 28, 2004 Notice of Docketing, we filed a brief supporting our appeal on June 17, 2004. All briefings were completed on July 22, 2004, and oral arguments were heard on October 13, 2004.

In addition, pursuant to our service contracts, we also generally indemnify our customers for the services we provide thereunder. Furthermore, because our services are integral to the operation and performance of the electric power transmission and distribution infrastructure, we may become subject to lawsuits or claims for any failure of the systems that we work on, even if our services are not the cause for such failures, and we could be subject to civil and criminal liabilities to the extent that our services contributed to any property damage or blackout. The outcome of these proceedings could result in significant costs and diversion of management's attention to our business. Payments of significant amounts, even if reserved, could adversely affect our reputation and liquidity position.

From time to time, we are a party to various other lawsuits, claims and other legal proceedings that arise in the ordinary course of our business. These actions typically seek, among other things, compensation for alleged personal injury, breach of contract, property damage, punitive damages, civil penalties or other losses, or injunctive or declaratory relief. With respect to such lawsuits, claims and proceedings, we accrue reserves when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. We do not believe any of these proceedings currently pending, individually or in the aggregate, would be expected to have a material adverse effect on our results of operations, cash flows, or financial condition.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The Securities and Exchange Commission (SEC) declared our first registration statement, which we filed on Form S-1 (File No. 333-112375) in connection with the initial public offering of our common stock, effective on May 6, 2004. Under this registration statement, we registered an aggregate offering price of \$128.6 million of our common stock, or 9,890,000 shares of common stock, including the shares subject to the underwriters' over-allotment option. We registered 8,500,000 of these shares on our behalf and 1,390,000 shares on behalf of certain selling stockholders. The selling stockholders sold 100,000 shares of common stock and granted the underwriters an over-allotment option to purchase an additional 1,290,000 shares of common stock, which option was not exercised.



The underwriting syndicate was managed by Lehman Brothers Inc. This offering terminated upon the closing of our initial public offering.

The initial public offering was completed on May 12, 2004, at a price to the public of \$13.00 per share, with an aggregate offering price of \$111.8 million. The sale of shares of common stock by us resulted in gross proceeds to us of \$110.5 million, \$7.3 million of which we applied to underwriting discounts and commissions and approximately \$2.4 million of which we applied to offering expenses. As a result, we received net proceeds of approximately \$100.8 million. The net proceeds of the offering were used by us as follows: (1) \$50.2 million was used to repay a portion of term loans outstanding under our senior credit facility; (2) \$30 million was used to repay the principal amount of our subordinated note with Exelon; and (3) the remaining proceeds of approximately \$20.6 million were retained for general corporate purposes.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements 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: November 15, 2004

INFRA SOURCE SERVICES, INC.  
(Registrant)

By:

/s/ TERENCE R. MONTGOMERY  
Terence R. Montgomery  
*Chief Financial Officer and Senior Vice President*

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**EXHIBIT INDEX**

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
  - 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934
  - 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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