

TRINET GROUP INC
Form 10-Q
November 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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

Commission File Number: 001-36373

TriNet Group, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware 95-3359658
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
1100 San Leandro Blvd., Suite 400
San Leandro, CA 94577
(Address of principal executive offices) (Zip code)
Registrant's telephone number, including area code: (510) 352-5000

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 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.

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

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

As of October 31, 2016, the registrant had 68,829,209 shares of common stock outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

TriNet Group, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

| | September 30, 2016 | December 31, 2015 |
|---|-----------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 160,558 | \$ 166,178 |
| Restricted cash | 14,563 | 14,557 |
| Prepaid income taxes | 6,310 | 4,105 |
| Prepaid expenses | 13,018 | 8,579 |
| Other current assets | 2,173 | 1,359 |
| Worksite employee related assets | 847,545 | 1,373,386 |
| Total current assets | 1,044,167 | 1,568,164 |
| Workers compensation receivable | 40,578 | 29,204 |
| Restricted cash and available for sale investments | 122,378 | 101,806 |
| Property and equipment, net | 53,141 | 37,844 |
| Goodwill | 289,207 | 289,207 |
| Other intangible assets, net | 32,424 | 46,772 |
| Other assets | 18,431 | 19,452 |
| Total assets | \$ 1,600,326 | \$ 2,092,449 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 18,461 | \$ 12,904 |
| Accrued corporate wages | 29,039 | 28,963 |
| Current portion of notes payable and borrowings under capital leases, net | 36,497 | 32,970 |
| Other current liabilities | 11,960 | 11,402 |
| Worksite employee related liabilities | 842,552 | 1,369,497 |
| Total current liabilities | 938,509 | 1,455,736 |
| Notes payable and borrowings under capital leases, net, less current portion | 431,638 | 460,965 |
| Workers compensation liabilities | 138,912 | 105,481 |
| Deferred income taxes | 54,411 | 54,641 |
| Other liabilities | 7,941 | 7,545 |
| Total liabilities | 1,571,411 | 2,084,368 |
| Commitments and contingencies (Note 9) | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.000025 per share stated value; 20,000,000 shares authorized; no shares issued and outstanding at September 30, 2016 and December 31, 2015 | — | — |
| Common stock, \$0.000025 per share stated value; 750,000,000 shares authorized; 69,659,283 and 70,371,425 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 522,910 | 494,397 |
| Accumulated deficit | (493,574) | (485,595) |
| Accumulated other comprehensive loss | (421) | (721) |
| Total stockholders' equity | 28,915 | 8,081 |

| | | |
|--|--------------|--------------|
| Total liabilities and stockholders' equity | \$ 1,600,326 | \$ 2,092,449 |
|--|--------------|--------------|

See accompanying notes.

TriNet Group, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands, except share and per share data)
 (Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Professional service revenues | \$ 110,493 | \$ 99,473 | \$ 332,489 | \$ 294,288 |
| Insurance service revenues | 659,964 | 568,535 | 1,916,753 | 1,639,305 |
| Total revenues | 770,457 | 668,008 | 2,249,242 | 1,933,593 |
| Costs and operating expenses: | | | | |
| Insurance costs | 609,422 | 534,481 | 1,775,784 | 1,535,678 |
| Cost of providing services (exclusive of depreciation and amortization of intangible assets) | 50,142 | 37,540 | 139,881 | 111,582 |
| Sales and marketing | 41,470 | 44,997 | 133,978 | 123,740 |
| General and administrative | 22,477 | 17,726 | 69,078 | 48,991 |
| Systems development and programming costs | 8,124 | 6,991 | 20,970 | 21,849 |
| Amortization of intangible assets | 4,662 | 10,459 | 14,647 | 32,284 |
| Depreciation | 5,188 | 4,132 | 13,663 | 10,761 |
| Total costs and operating expenses | 741,485 | 656,326 | 2,168,001 | 1,884,885 |
| Operating income | 28,972 | 11,682 | 81,241 | 48,708 |
| Other income (expense): | | | | |
| Interest expense and bank fees | (5,597) | (4,685) | (15,677) | (14,653) |
| Other, net | 313 | 355 | 434 | 873 |
| Income before provision for income taxes | 23,688 | 7,352 | 65,998 | 34,928 |
| Provision for income taxes | 9,107 | 4,255 | 27,558 | 17,328 |
| Net income | \$ 14,581 | \$ 3,097 | \$ 38,440 | \$ 17,600 |
| Net income per share: | | | | |
| Basic | \$ 0.21 | \$ 0.04 | \$ 0.55 | \$ 0.25 |
| Diluted | \$ 0.20 | \$ 0.04 | \$ 0.53 | \$ 0.24 |
| Weighted average shares: | | | | |
| Basic | 70,187,989 | 70,237,737 | 70,478,266 | 70,247,035 |
| Diluted | 71,964,603 | 72,087,917 | 72,126,060 | 72,757,277 |

See accompanying notes.

TriNet Group, Inc. and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three Months | | Nine Months | |
|---|-----------------|---------|-----------------|----------|
| | Ended September | | Ended September | |
| | 30, | 30, | 30, | 30, |
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |
| Other comprehensive income (loss), net of tax | | | | |
| Unrealized gains (losses) on available for sale investments | (83) | 11 | 166 | 48 |
| Foreign currency translation adjustments | (42) | (130) | 134 | (239) |
| Total other comprehensive income (loss), net of tax | (125) | (119) | 300 | (191) |
| Comprehensive income | \$14,456 | \$2,978 | \$38,740 | \$17,409 |

See accompanying notes.

TriNet Group, Inc. and Subsidiaries
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands)
 (Unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2016 | 2015 |
| Operating activities | | |
| Net income | \$38,440 | \$17,600 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 27,810 | 42,036 |
| Deferred income taxes | (346) | 1,835 |
| Stock-based compensation | 20,169 | 12,991 |
| Excess tax credits received from equity incentive plan activity | (2,591) | (20,327) |
| Changes in operating assets and liabilities: | | |
| Restricted cash and available for sale investments | (31,409) | (21,198) |
| Prepaid expenses and other current assets | (5,253) | (3,201) |
| Workers compensation receivables | (11,374) | 3,294 |
| Other assets | 438 | (14,585) |
| Accounts payable | 4,538 | 2,522 |
| Prepaid income taxes | 386 | 27,574 |
| Accrued corporate wages and other current liabilities | 4,548 | 9,103 |
| Workers compensation and other liabilities | 33,856 | 47,419 |
| Worksite employee related assets | 525,841 | 768,010 |
| Worksite employee related liabilities | (526,945) | (768,552) |
| Net cash provided by operating activities | 78,108 | 104,521 |
| Investing activities | | |
| Acquisitions of businesses | (300) | (4,750) |
| Purchases of restricted investments | (14,959) | (14,989) |
| Proceeds from maturities of restricted investments | 25,790 | 1,275 |
| Purchase of property and equipment | (27,942) | (14,747) |
| Net cash used in investing activities | (17,411) | (33,211) |
| Financing activities | | |
| Proceeds from issuance of notes payable | 57,978 | — |
| Payments for extinguishment of debt | (57,563) | — |
| Payment of debt issuance costs | (1,376) | — |
| Repayment of notes payable and capital leases | (27,506) | (40,493) |
| Proceeds from issuance of common stock on exercised options | 3,584 | 6,464 |
| Proceeds from issuance of common stock on employee stock purchase plan | 2,304 | 2,723 |
| Repurchase of common stock | (43,747) | (48,364) |
| Awards effectively repurchased for required employee withholding taxes | (2,672) | (576) |
| Excess tax credits received from equity incentive plan activity | 2,591 | 20,327 |
| Tax credit received for deductible IPO transaction costs | — | 822 |
| Net cash used in financing activities | (66,407) | (59,097) |
| Effect of exchange rate changes on cash and cash equivalents | 90 | (239) |
| Net increase in cash and cash equivalents | (5,620) | 11,974 |
| Cash and cash equivalents at beginning of period | 166,178 | 134,341 |
| Cash and cash equivalents at end of period | \$160,558 | \$146,315 |

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Supplemental disclosures of cash flow information

| | | |
|---|----------|----------|
| Cash paid for interest | \$11,651 | \$11,378 |
| Cash paid for income taxes, net | 27,650 | 1,467 |
| Supplemental schedule of noncash investing and financing activities | | |
| Payable for purchase of property and equipment | 1,363 | 68 |
| See accompanying notes. | | |

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TriNet Group, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

TriNet Group, Inc. (the Company or TriNet), a Delaware corporation incorporated in January 2000, provides comprehensive human resources (HR), solutions for small to midsize businesses, or SMBs, across a number of industries under a co-employment model. The Company's HR solutions are designed to manage an increasingly complex set of HR regulations, costs, risks and responsibilities for its clients, allowing them to focus on operating and growing their core businesses. These HR solutions include offerings, such as multi-state payroll processing and tax administration, employee benefits programs (including health insurance and retirement plans), workers compensation insurance and claims management, federal, state and local labor, employment and benefit law compliance, risk mitigation, expense and time management, human capital consulting and other services.

TriNet's proprietary, cloud-based HR software systems are used by its clients and their employees, whom the Company refers to as worksite employees, or WSEs, to store and manage their core HR-related information and conduct a variety of HR-related transactions. In addition, TriNet's teams of in-house HR professionals also provide additional services upon request to support various stages of TriNet clients' growth, including talent management, recruiting and training, performance management consulting or other consulting services.

TriNet's clients are distributed across a variety of industries, including technology, life sciences, not-for-profit, professional services, financial services, property management, retail, manufacturing, and hospitality. TriNet's sales and marketing, client services and product development teams are increasingly focused on specific industry verticals. This vertical approach helps give us a better understanding of the HR needs facing SMBs in particular industries, which we believe helps us provide HR solutions and services tailored to the specific needs of clients in these verticals.

Segment Information

The Company operates in one reportable segment. All of the Company's service revenues are generated from external clients. Less than 1% of revenue is generated outside of the United States of America (U.S.). Substantially all of the Company's long-lived assets are located in the U.S.

Basis of Presentation

These unaudited condensed consolidated financial statements (Financial Statements) and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting and, in the opinion of management, reflect all adjustments, consisting of normally recurring adjustments, necessary for fair presentation of the interim financial results of the Company. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In addition, all intercompany accounts and transactions have been eliminated in consolidation. Therefore, these Financial Statements and notes should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The accompanying unaudited condensed consolidated balance sheets present the current assets and current liabilities directly related to the processing of HR transactions as WSE-related assets and WSE-related liabilities, respectively. WSE-related assets consist of cash and investments restricted for current workers compensation claim payments, payroll funds collected, accounts receivable, unbilled service revenues, and refundable or prepaid amounts related to the Company-sponsored workers compensation and health plan programs. WSE-related liabilities consist of client prepayments, wages and payroll taxes accrued and payable, and liabilities related to the Company-sponsored workers compensation and health plan programs resulting from workers compensation case reserves, premium amounts due to providers for enrolled employees, and workers compensation and health reserves that are expected to be disbursed within the next 12 months.

Certain prior period amounts in the Financial Statements have been reclassified to conform to the current presentation. The results of the nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016.

Seasonality and Insurance Variability

The Company's business is affected by cyclicity in business activity and WSE behavior. Historically, the Company has experienced its highest monthly addition of WSEs, as well as its highest monthly levels of client attrition, in the month of January, primarily because clients that change their payroll service providers tend to do so at the beginning of a calendar year. In addition, the Company experiences higher levels of client attrition in connection with renewals of the health insurance TriNet sponsors for its WSEs, in the event that such renewals result in higher costs to its clients. The Company has also historically experienced higher insurance claim volumes in the second and third quarters of the year than in the first and fourth quarters, as WSEs typically access their health care providers more often in the second and third quarters, which has negatively impacted the Company's insurance costs in these quarters. The Company has also experienced variability on a quarterly basis in the amount of our health and workers compensation insurance costs due to the number and severity of insurance claims being unpredictable. These historical trends may change, and other seasonal trends and variability may develop which could make it more difficult for the Company to manage its business.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. These estimates include, but are not limited to, allowances for accounts receivable, workers compensation-related reserve estimates, health plan reserve estimates, recoverability of goodwill and other intangible assets, income taxes, stock-based compensation and other contingent liabilities. Such estimates are based on historical experience and on various other assumptions that management believes to be reasonable under the circumstances. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-15—Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The amendment is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective transition method. The Company is currently in the process of evaluating the impact of the adoption of this standard on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, as part of the Simplification Initiative. The areas for simplification in this update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. The amendment is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2016. Early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of this standard on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02—Leases. The amendment requires that lease arrangements longer than 12 months result in an entity recognizing an asset and liability. The amendment is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2018. Early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of this standard on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03—Simplifying the Presentation of Debt Issuance Costs, and, in August 2015, the FASB issued ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. These ASUs require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt, which is consistent with the presentation of debt discounts and premiums. The presentation and subsequent measurement of debt issuance costs associated with lines of credit, may be presented as an asset and amortized ratably over the term of the line of credit arrangement, regardless of whether there are outstanding borrowings on the arrangement. The recognition and measurement guidance for debt issuance costs are not affected by these ASUs. The Company adopted these ASUs as

of March 31, 2016. The adoption of these ASUs resulted in a reclassification of unamortized debt issuance costs of \$2.4 million from other current assets to current portion of notes payable and borrowings under capital leases and \$3.4 million from other assets to notes payable and borrowings under capital leases, less current portion, as of December 31, 2015. Unamortized debt issuance costs related to the Company's revolving credit facility will remain classified as an other asset in the accompanying consolidated balance sheets. The adoption of this guidance did not have any impact on the Company's consolidated statements of operations, comprehensive income or cash flows.

In May 2014, the FASB issued ASU 2014-09—Revenue from Contracts with Customers, which will replace most existing revenue recognition guidance under GAAP. The core principle of the guidance is that an entity should 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 standard provides a five-step analysis of transactions to determine when and how revenue is recognized. In July 2015, the FASB deferred the effective date to annual reporting periods, and interim periods within those years, beginning after December 15, 2017. Early adoption at the original effective date of December 15, 2016 is permitted. The amendments may be applied retrospectively or as a cumulative-effect adjustment as of the date of adoption. In March, April and May 2016, the FASB issued ASU 2016-08 Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10 Identifying Performance Obligations and Licensing and ASU 2016-12 Narrow-Scope Improvements and Practical Expedients, respectively, providing further clarification to be considered when implementing ASU 2014-09. The Company has not yet selected a method of adoption and is currently evaluating the effect that the amendments will have on the consolidated financial statements.

NOTE 2. WORKSITE EMPLOYEE-RELATED ASSETS AND LIABILITIES

The following schedule presents the components of the Company's WSE-related assets and WSE-related liabilities (in thousands):

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| Worksite employee-related assets: | | |
| Restricted cash | \$ 113,934 | \$ 92,917 |
| Restricted investments | 2,319 | 3,819 |
| Payroll funds collected | 442,329 | 859,322 |
| Unbilled revenue, net of advance collections of \$5,504 and \$11,875 at September 30, 2016 and December 31, 2015, respectively | 268,480 | 213,837 |
| Accounts receivable, net of allowance for doubtful accounts of \$430 and \$1,158 at September 30, 2016 and December 31, 2015, respectively | 4,701 | 5,060 |
| Prepaid health plan expenses | 6,692 | 8,088 |
| Workers compensation receivables | 1,860 | 2,428 |
| Prepaid workers compensation expenses | 3,057 | 744 |
| Other payroll assets | 4,173 | 187,171 |
| Total worksite employee-related assets | \$ 847,545 | \$ 1,373,386 |
| Worksite employee-related liabilities: | | |
| Unbilled wages accrual | \$ 254,267 | \$ 202,396 |
| Payroll taxes payable | 312,097 | 883,608 |
| Health benefits payable | 131,038 | 128,028 |
| Customer prepayments | 38,143 | 57,758 |
| Workers compensation payable | 64,432 | 66,174 |
| Other payroll deductions | 42,575 | 31,533 |
| Total worksite employee-related liabilities | \$ 842,552 | \$ 1,369,497 |

Other payroll assets and payroll taxes payable above include a receivable due from one client at December 31, 2015 for \$181 million related to an end of year payroll tax liability for which funding was received in January 2016.

Payroll taxes payable, workers compensation payable and health benefits payable also include the related amounts of approximately 2,500 Company employees.

NOTE 3. WORKERS COMPENSATION ASSETS AND LIABILITIES

The Company has agreements with various insurance carriers to provide workers compensation insurance coverage for worksite employees, including agreements in which either the Company retains custody of funds in restricted accounts or remits funds to carriers to pay future claims. Insurance carriers are responsible for administering and paying claims. The Company is responsible for reimbursing each carrier up to a deductible limit per occurrence. Assets held by third parties to cover claim liabilities represent prefunded claim obligations paid to carriers in excess of estimated total claim liabilities and are applied to incurred claims. Any excess claim funds held by the carrier can be returned to the Company based on their agreements with the Company.

The following summarizes the activities in the balance sheet for unpaid claims and claims adjustment expenses within workers compensation assets and liabilities (in thousands):

| | Nine Months Ended September 30, 2016 | Year Ended December 31, 2015 |
|--|--|---------------------------------------|
| Liability for unpaid claims and claims adjustment at beginning of period | \$190,102 | \$148,034 |
| Incurred related to: | | |
| Current year | 78,063 | 89,137 |
| Prior years | 12,951 | 26,391 |
| Total incurred | 91,014 | 115,528 |
| Paid related to: | | |
| Current year | (9,016) | (16,376) |
| Prior years | (49,593) | (57,084) |
| Total paid | (58,609) | (73,460) |
| Liability for unpaid claims and claims adjustment at end of period | \$222,507 | \$190,102 |
| Assets held by third parties to cover claim liabilities | (73,277) | (58,522) |
| Workers compensation premiums and other liabilities | 12,761 | 9,455 |
| Other workers compensation assets | (1,085) | (1,012) |
| Total net workers compensation liabilities | \$160,906 | \$140,023 |
| Location on Condensed Consolidated Balance Sheet: | | |
| Workers compensation liabilities | | |
| Current portion included in worksite employee-related liability | \$64,432 | \$66,174 |
| Long term portion | 138,912 | 105,481 |
| Total workers compensation liabilities | \$203,344 | \$171,655 |
| Workers compensation receivables | | |
| Current portion included in worksite employee-related asset | \$(1,860) | \$(2,428) |
| Long term portion | (40,578) | (29,204) |
| Total workers compensation receivables | \$(42,438) | \$(31,632) |
| Total net workers compensation liabilities | \$160,906 | \$140,023 |

Incurred claims related to prior years represent changes in estimates for ultimate losses on workers compensation claims.

As of September 30, 2016 and December 31, 2015, the company recorded \$59.8 million and \$49.8 million, respectively, in restricted cash and restricted investments within WSE-related assets in the accompanying condensed consolidated balance sheets. In addition, at September 30, 2016 and December 31, 2015, \$122.4 million and \$101.8 million, respectively, were recorded as restricted long-term cash and available for sale investments. These funds remain restricted until the plan year to which they relate are settled.

NOTE 4. MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS

At September 30, 2016, the Company's noncurrent restricted cash and available for sale investments totaling \$122.4 million, includes \$54.0 million of available for sale marketable securities and \$68.4 million of cash. At December 31, 2015, the Company's noncurrent restricted cash and available for sale investments totaling \$101.8 million, includes \$63.1 million of available for sale marketable securities and \$38.7 million of cash. The Company's restricted investments within WSE-related assets include \$2.3 million of certificates of deposit as of September 30, 2016 and December 31, 2015. The available for sale marketable securities as of September 30, 2016 and December 31, 2015 consist of the following (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| September 30, 2016: | | | | |
| U.S. treasuries | \$ 53,376 | \$ 152 | \$ (12) | \$ 53,516 |
| Mutual funds | 500 | 9 | — | 509 |
| Total investments | \$ 53,876 | \$ 161 | \$ (12) | \$ 54,025 |
| December 31, 2015: | | | | |
| U.S. treasuries | \$ 64,226 | \$ 9 | \$ (144) | \$ 64,091 |
| Mutual funds | 500 | 4 | — | 504 |
| Total investments | \$ 64,726 | \$ 13 | \$ (144) | \$ 64,595 |

There were no realized gains or losses for the nine months ended September 30, 2016 and 2015. As of September 30, 2016, all of the Company's U.S. treasuries had contractual maturity dates of less than three years.

As of September 30, 2016 and December 31, 2015, the Company had de minimis and \$0.1 million in gross unrealized losses, respectively, in its U.S. Treasury securities. The fair value of the securities in an unrealized loss position represented approximately 28% and 81% of the total fair value of all U.S. Treasury securities as of September 30, 2016 and December 31, 2015, respectively. Unrealized losses are principally caused by changes in interest rates. In analyzing an issuer's financial condition, the Company considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As the Company has the ability and intent to hold debt securities until recovery, or for the foreseeable future as classified as available for sale, no decline was deemed to be other-than-temporary.

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.

As a basis for considering such assumptions, the Company uses a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level I—observable inputs for identical assets or liabilities, such as quoted prices in active markets
- Level II—inputs other than the quoted prices in active markets that are observable either directly or indirectly
- Level III—unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions

This hierarchy requires the Company to use observable market data when available and to minimize the use of unobservable inputs when determining fair value.

The following table summarizes the Company's financial assets measured at fair value on a recurring basis (in thousands):

| | Total Fair Value | Level I | Level II | Level III |
|-------------------------|------------------------|----------|-------------|--------------|
| September 30, 2016: | | | | |
| Certificates of deposit | \$2,319 | \$2,319 | \$ — | — |
| U.S. treasuries | 53,516 | 53,516 | — | — |
| Mutual funds | 509 | 509 | — | — |
| Total | \$56,344 | \$56,344 | \$ — | — |
| December 31, 2015: | | | | |
| Certificates of deposit | \$2,319 | \$2,319 | \$ — | — |
| U.S. treasuries | 64,091 | 64,091 | — | — |
| Mutual funds | 504 | 504 | — | — |
| Total | \$66,914 | \$66,914 | \$ — | — |

There were no transfers between Level I and Level II assets during the nine months ended September 30, 2016 or the year ended December 31, 2015.

As of September 30, 2016 and December 31, 2015, certificates of deposit were held by domestic financial institutions, which are presented as restricted investments within WSE-related assets as described in Note 2.

The carrying value of the Company's financial instruments not measured at fair value, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable, approximates fair value due to their relatively short term nature. The fair value of these instruments would be categorized as Level II of the fair value hierarchy, with the exception of cash and cash equivalents, and restricted cash, which would be categorized as Level I.

At September 30, 2016 and December 31, 2015, the carrying value of the Company's notes payable of \$472.5 million and \$499.6 million, respectively, approximated fair value. The estimated fair values of the Company's notes payable are considered a Level II valuation in the hierarchy for fair value measurement and are based on a cash flow model discounted at market interest rates that considers the underlying risks of unsecured debt.

NOTE 5. NOTES PAYABLE AND BORROWINGS UNDER CAPITAL LEASES

As of September 30, 2016, notes payable and borrowings under capital leases consisted of the following (in thousands):

| | September 30, 2016 | December 31, 2015 | Annual Contractual Interest Rate | Effective Interest Rate | Maturity Date |
|--|-----------------------|----------------------|---|-------------------------------|------------------|
| Term loan A | \$ 337,500 | \$ 351,563 | 3.09 % ⁽¹⁾ | 3.15 % | July 2019 |
| Term loan B | — | 148,000 | N/A | N/A | July 2017 |
| Term loan A-2 | 135,000 | — | 2.97 % ⁽²⁾ | 2.99 % | July 2019 |
| Total term loans | 472,500 | 499,563 | | | |
| Deferred loan costs | (4,490) | (5,781) | | | |
| Capital leases | 125 | 153 | | | |
| Less: current portion of notes payable and borrowings under capital leases | (36,497) | (32,970) | | | |
| Long term portion | \$ 431,638 | \$ 460,965 | | | |

(1) Bears interest at LIBOR plus 2.25% or the prime rate plus 1.25% at the Company's option, subject to certain rate adjustments based upon the Company's total leverage ratio.

(2) Bears interest at LIBOR plus 2.125% or the prime rate plus 1.125% at the Company's option, subject to certain rate adjustments based upon the Company's total leverage ratio.

In July 2016, the Company refinanced its Amended and Restated First Lien Credit Agreement (Credit Agreement). The Company exchanged its \$135 million of outstanding tranche B term loans maturing July 2017 with substantially the same

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amount of the new tranche A-2 term loans maturing July 2019. The \$342 million of existing tranche A term loans and the \$75 million revolving credit facility were not changed. As part of the \$135 million refinancing transaction, \$57.6 million was recorded as an extinguishment, and \$77.0 million was rolled over into the new tranche A-2 term loans and was treated as a debt modification.

The proceeds of the tranche A-2 term loans were used to (i) refinance the remaining tranche B term loans outstanding under the Credit Agreement and (ii) pay related fees and expenses. As a result of this refinancing, approximately \$1.4 million in fees and costs were incurred, of which \$0.8 million were recorded as deferred loan costs with the remainder expensed. Also as a result of this refinancing, the Company expensed \$0.3 million of the loan fees associated with a previous refinancing of the Company's Credit Agreement.

The Company is required to pay a commitment fee of 0.50%, subject to decrease to 0.375% based on its total leverage ratio, on the daily unused amount of the commitments under the revolving credit facility, as well as fronting fees and other customary fees for letters of credit issued under the revolving credit facility.

The Company is permitted to make voluntary prepayments at any time without payment of a premium. The Company is required to make mandatory prepayments of term loans (without payment of a premium) with (i) net cash proceeds from issuances of debt (other than certain permitted debt), and (ii) net cash proceeds from certain non-ordinary course asset sales and casualty and condemnation proceeds (subject to reinvestment rights and other exceptions).

The Tranche A and A-2 term loans will be repaid in quarterly installments in aggregate annual amounts as follows (in thousands):

Year ending December 31:

| | |
|-------|-----------|
| 2016 | \$9,563 |
| 2017 | 38,250 |
| 2018 | 41,438 |
| 2019 | 383,249 |
| Total | \$472,500 |

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries. The Credit Agreement also contains financial covenants that require the Company to maintain a minimum consolidated interest coverage ratio of at least 3.50 to 1.00 and a maximum total leverage ratio, currently at 4.25 to 1.00. The Company was in compliance with these financial covenants under the credit facilities at September 30, 2016.

The credit facility is secured by substantially all of the Company's assets and the assets of the borrower and its subsidiaries, other than specifically excluded assets.

NOTE 6: STOCKHOLDERS' EQUITY

Equity-Based Incentive Plans

In 2000, the Company established the 2000 Equity Incentive Plan (the 2000 Plan), which provided for granting incentive stock options, nonstatutory stock options, bonus awards and restricted stock awards to eligible employees, directors, and consultants of the Company. In December 2009, the board of directors approved the 2009 Equity Incentive Plan (the 2009 Plan) as the successor to and continuation of the 2000 Plan. As of the 2009 Plan effective date, remaining shares available for issuance under the 2000 Plan were cancelled and became available for issuance under the 2009 Plan. No additional stock awards will be granted under the 2000 Plan. The 2009 Plan provides for the grant of the following awards to eligible employees, directors, and consultants: incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance stock awards, performance cash awards, and other stock awards. Incentive stock options may only be granted to employees. Non-employee directors are eligible to receive restricted stock units (RSUs) automatically at designated intervals over their period of continuous service on the board of directors. The 2009 Plan, as amended, provides that the number of shares reserved for issuance under the 2009 Plan will increase on January 1 of each year for a period of up to five years by 4.5% of the total number of shares of capital stock outstanding on December 31 of the preceding calendar year, which will begin on January 1, 2015 and continue through January 1, 2019. On January 1, 2016, an additional 3,166,714 shares were automatically reserved for issuance under the amended 2009 Plan.

Stock Options

The exercise price per share of all incentive stock options granted under the 2000 Plan and the 2009 Plan must be at least equal to the fair market value of the shares at the date of grant as determined by the board of directors. Options generally have a maximum contractual term of 10 years. For employees who hold greater than 10% of the stock or voting power of the Company, incentive stock options are granted at 110% of fair market value and have a maximum term of five years. Options granted to non-employee directors upon their initial election or appointment generally vest at the rate of 33% of the total options granted on the first anniversary of the option grant date, with 1/36 of the total options granted vesting each month thereafter. All other options granted to non-employee directors generally fully vest on the first anniversary of the option grant date. Before 2015, options granted to employees generally vested over four years with 25% of the total options granted vesting on the first anniversary of the grant date with the remaining options vesting in equal monthly installments over the three years thereafter. Starting in 2015, options granted to newly hired employees generally vest at a rate of 25% of the total options granted on the first anniversary of the grant date with 1/16 of the total options granted vesting on the 15th day of the second month of each calendar quarter thereafter. Options granted to existing employees generally vest at a rate of 1/16 of the total options granted on the 15th day of the second month of each calendar quarter following the grant date.

Restricted Stock Units

The fair value of Company RSUs is equal to the fair value of the Company's common stock on the grant date. RSUs granted to non-employee directors generally fully vest on the first anniversary of the grant date. RSUs granted to newly hired employees generally vest at a rate of 25% of the total RSUs granted on the first anniversary of the grant date with 1/16 of the total RSUs granted vesting on the 15th day of the second month of each calendar quarter thereafter. RSUs granted to existing employees generally vest at a rate of 1/16 of the total RSUs granted on the 15th day of the second month of each calendar quarter following the grant date.

Performance-based Restricted Stock Units

In March 2015, the Company granted performance-based restricted stock units (PSUs) to its executives. Performance is measured in tranches under these PSUs over 12-month, 24-month and 36-month periods that each start on January 1, 2015. PSUs are credited following each tranche measurement period and are capped at 150% of the total PSU target grant for the first and second measurement period. The maximum potential earned amount tied to the full three-year performance period is capped at 200% of the total PSU target grant. The PSUs will be credited and ultimately vest over the three tranche measurement periods under the PSUs based on the Company's attainment of financial performance goals as well as the executive's continued employment through each vesting date. Cumulative financial performance metrics and goals are established for these awards at the grant date and the tranche of each award related to that period's performance goal is treated as a separate grant for accounting purposes. The financial performance metric established for the performance awards is cumulative annual growth rate in the Company's net service revenues. These values are being recognized over the 12-month, 24-month and 36-month tranche measurement periods of the PSUs. The Company began recording stock-based compensation expense for these tranches in March 2015 based on the grant date fair values of the PSUs, adjusted for forfeitures, when the financial performance goals were established. In addition, these compensation expenses are recognized ratably over the vesting period based on the probability of the number of awards expected to vest at each reporting date.

Equity incentive plan activity for the nine months ended September 30, 2016 is summarized as follows:

| Equity Incentive Plan Activity | Shares Available for Grant |
|--|----------------------------|
| Balance at December 31, 2015 | 4,991,583 |
| Authorized | 3,166,714 |
| Granted | (2,195,407) |
| Forfeited | 400,766 |
| Expired | 65,626 |
| Shares withheld for taxes and not issued | 151,826 |
| Balance at September 30, 2016 | 6,581,108 |

The following table summarizes stock option activity under the Company's equity-based plans for the nine months ended September 30, 2016:

| Stock Option Activity | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
|-------------------------------|------------------|---------------------------------|---|--|
| Balance at December 31, 2015 | 4,446,149 | \$ 8.96 | 7.56 | \$ 52,108 |
| Exercised | (931,330) | 3.85 | | |
| Forfeited | (231,625) | 18.45 | | |
| Expired | (65,626) | 28.59 | | |
| Balance at September 30, 2016 | 3,217,568 | \$ 9.35 | 6.88 | \$ 42,872 |

| | | | | |
|---|-----------|---------|------|-----------|
| Exercisable at September 30, 2016 | 2,126,351 | \$ 7.33 | 6.61 | \$ 31,741 |
| Vested and expected to vest at September 30, 2016 | 3,160,624 | \$ 9.21 | 6.86 | \$ 42,442 |

There were no stock options granted during the nine months ended September 30, 2016. The weighted average grant date fair value of stock options granted during the three months ended September 30, 2015 was \$8.09 per share. The weighted average grant date fair value of stock options granted during the nine months ended September 30, 2015 was \$12.85 per share. The total grant date fair value of options vested for the three months ended September 30, 2016 and 2015 was \$1.6 million and \$1.8 million, respectively. The total grant date fair value of options vested for the nine months ended September 30, 2016 and 2015 was \$5.3 million and \$7.5 million, respectively.

The total intrinsic value of options exercised for the three months ended September 30, 2016 and 2015 was \$5.7 million and \$7.3 million, respectively. The total intrinsic value of options exercised for the nine months ended September 30, 2016 and 2015 was \$13.9 million and \$50.3 million, respectively. Cash received from options exercised during the nine months ended September 30, 2016 and 2015 was \$3.6 million and \$6.5 million, respectively. The exercise price of all options granted was equal to the fair value of the common stock on the date of grant.

As of September 30, 2016, unrecognized compensation expense, net of forfeitures, associated with nonvested options outstanding was \$7.2 million and is expected to be recognized over a weighted average period of 1.56 years.

The following table summarizes RSU activity under the Company's equity-based plans for the nine months ended September 30, 2016:

| Restricted Stock Unit Activity | Number of Units | Weighted Average Grant Date Fair Value |
|---------------------------------|-----------------|--|
| Nonvested at December 31, 2015 | 956,687 | \$ 28.03 |
| Granted | 2,195,407 | \$ 18.09 |
| Vested | (511,210) | \$ 24.13 |
| Forfeited | (145,267) | \$ 22.95 |
| Nonvested at September 30, 2016 | 2,495,617 | \$ 20.37 |

The total grant date fair value of RSUs granted in the three months ended September 30, 2016 and 2015 was \$3.8 million and \$3.0 million, respectively. The total grant date fair value of RSUs granted in the nine months ended September 30, 2016 and 2015 was \$39.7 million and \$27.9 million, respectively. The total grant date fair value of RSUs vested in the three months ended September 30, 2016 and 2015 was \$3.7 million and \$1.2 million, respectively. The total grant date fair value of RSUs vested in the nine months ended September 30, 2016 and 2015 was \$12.3 million and \$2.3 million, respectively. As of September 30, 2016, unrecognized compensation expense, net of forfeitures, associated with the nonvested RSUs outstanding was \$45.3 million, and is expected to be recognized over

a weighted average period of 2.90 years.

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The following table summarizes PSU activity under the Company's equity-based plans for the nine months ended September 30, 2016:

| Performance Based Restricted Stock Unit Activity | Number of Units | Weighted Average Grant Date Fair Value |
|--|-----------------|--|
| Outstanding units at December 31, 2015 | 173,286 | \$ 33.51 |
| Granted | — | \$ — |
| Units converted | — | \$ — |
| Forfeited | (23,874) | \$ 33.51 |
| Outstanding units at September 30, 2016 | 149,412 | \$ 33.51 |

As of September 30, 2016, there was \$0.5 million of total unrecognized compensation expense, net of estimated forfeitures, associated with nonvested PSUs outstanding, which is expected to be recognized over a period of 1.25 years.

Employee Stock Purchase Plan

The Company adopted the 2014 Employee Stock Purchase Plan (ESPP) in February 2014, which became effective on March 26, 2014. The ESPP was approved with a reserve of 1.1 million shares of common stock for future issuance under various terms provided for in the ESPP, which will automatically increase on January 1 of each year from 2015 through 2024 by the lesser of 1% of the total number of shares outstanding on December 31 of the preceding calendar year or 1,800,000 shares. On January 1, 2016, an additional 703,714 shares were automatically reserved for issuance under the ESPP. The purchase price is equal to the lesser of 85% of the fair market value of the common stock on the offering date and 85% of the fair market value of the common stock on the applicable purchase date. Offering periods are six months in duration and will end on or about May 15 and November 15 of each year. Employees may contribute a minimum of 1% and a maximum of 15% of their earnings. During the nine months ended September 30, 2016, employees purchased 147,354 shares under the ESPP at a price of \$15.64 per share for cash proceeds of \$2.3 million.

Stock Repurchases

In May 2014, the board of directors authorized a program to repurchase in the aggregate up to \$15 million of the Company's outstanding common stock. The board of directors subsequently approved incremental increases to the ongoing stock repurchase program of an additional \$30 million in November 2014, an additional \$50 million in June 2015 and an additional \$50 million in February 2016. In 2015, the Company repurchased approximately \$48.4 million of its outstanding common stock. During the nine months ended September 30, 2016, the Company repurchased 2,150,210 shares of common stock for \$43.7 million. As of September 30, 2016, \$37.9 million remained available for further repurchases of the Company's common stock under the Company's ongoing stock repurchase program. Stock repurchases under the program are primarily intended to offset the dilutive effect of share-based employee incentive compensation.

Stock-Based Compensation

Stock-based compensation expense of \$20.2 million and \$13.0 million was recognized for the nine months ended September 30, 2016 and 2015, respectively. Income tax benefit of \$7.1 million and \$4.2 million was recognized relating to stock-based compensation expense for the nine months ended September 30, 2016 and 2015, respectively. The tax benefit realized from stock options exercised was \$4.1 million and \$16.4 million for the nine months ended September 30, 2016 and 2015, respectively.

The fair value of stock-based awards is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

| Stock Option Assumptions | Three Months Ended | Nine Months Ended |
|--------------------------|--------------------|-------------------|
| | September 30, | September 30, |
| | Ended | Ended |

| | September 30, | | | |
|--------------------------|------------------|--------|------|------------|
| | 2016 | 2015 | 2016 | 2015 |
| Expected term (in years) | N/A | 6.11 | N/A | 6.08-6.11 |
| Expected volatility | N/A | 46 % | N/A | 39-46% |
| Risk-free interest rate | N/A | 1.62 % | N/A | 1.62-1.96% |
| Expected dividend yield | N/A | 0 % | N/A | 0 % |

| ESPP Assumptions | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------|----------------------------------|--------|---------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| Expected term (in years) | 0.50 | 0.50 | 0.50 | 0.50 |
| Expected volatility | 43 % | 43 % | 43-76% | 34-43% |
| Risk-free interest rate | 0.38 % | 0.08 % | 0.33-0.38 % | 0.07-0.08 % |
| Expected dividend yield | 0 % | 0 % | 0 % | 0 % |

Stock-based compensation expense for stock-based awards made to the Company's employees pursuant to the equity plans was as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|---------|---------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of providing services | \$1,605 | \$1,079 | \$5,044 | \$3,051 |
| Sales and marketing | 1,491 | 1,029 | 5,119 | 3,255 |
| General and administrative | 2,544 | 1,633 | 8,161 | 5,497 |
| Systems development and programming costs | 624 | 447 | 1,845 | 1,188 |
| | \$6,264 | \$4,188 | \$20,169 | \$12,991 |

NOTE 7: EARNINGS PER SHARE

The following table sets forth the computation of the Company's basic and diluted net income per share attributable to common stock (in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|---------|---------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |
| Weighted average shares of common stock outstanding | 70,188 | 70,238 | 70,478 | 70,247 |
| Basic EPS | \$0.21 | \$0.04 | \$0.55 | \$0.25 |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |
| Weighted average shares of common stock | 70,188 | 70,238 | 70,478 | 70,247 |
| Dilutive effect of stock options and restricted stock units | 1,777 | 1,850 | 1,648 | 2,510 |
| Weighted average shares of common stock outstanding | 71,965 | 72,088 | 72,126 | 72,757 |
| Diluted EPS | \$0.20 | \$0.04 | \$0.53 | \$0.24 |
| Common stock equivalents excluded from income per diluted share because of their anti-dilutive effect | 817 | 1,321 | 912 | 957 |

NOTE 8. INCOME TAXES

The Company is subject to income taxation in the United States and Canada. However, business is conducted primarily in the United States. The effective income tax rate differs from the statutory rate primarily due to state taxes, non-deductible stock-based compensation, tax credits, non-deductible charges, changes in uncertain tax positions, and other discrete items. The Company makes estimates and judgments about its future taxable income based on assumptions that are included in the Company's plans. Should the actual amounts differ from these estimates, the amount of the valuation allowance could be materially affected.

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Changes in valuation allowances are reflected as a component of provision for income taxes.

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The Company's effective income tax rate was 38.4% and 57.9% for the three months ended September 30, 2016 and 2015, respectively, and 41.8% and 49.6% for the nine months ended September 30, 2016 and 2015, respectively. The decrease is primarily due to a tax benefit related to prior year state income tax adjustments recorded in the three months ended September 30, 2016 and an expense related to revaluation of deferred taxes resulting from regulatory state tax law changes recorded in the three months ended September 30, 2015.

The Company is subject to taxation under the laws of the U.S. and various state and local jurisdictions, as well as Canada. The Company is not subject to any material income tax examinations by U.S. federal or state tax authorities for tax years beginning prior to January 1, 2011. The Company paid assessments of tax related to the disallowance of employment tax credits totaling \$10.5 million in connection with the Internal Revenue Service's (IRS) examination of Gevity HR, Inc. and its subsidiaries, which was acquired by TriNet in June 2009. On June 28, 2016, the Company filed a complaint in the United States District Court for the Middle District of Florida seeking a refund of the amounts previously paid to the IRS. With regard to these employment tax credits, the Company believes it is more likely than not that the Company will prevail in having these amounts refunded from the tax authorities. Therefore, no reserve has been recognized related to this matter.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company leases office facilities, including its headquarters and other facilities, and equipment under non-cancelable operating leases. The Company also leases certain software and furniture, fixtures, and equipment under capital leases. The lease agreements generally provide for rental payments on a graduated basis and for options to renew, which could increase future minimum lease payments if exercised. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid. Rent expense for the three months ended September 30, 2016 and 2015 was \$4.3 million and \$3.2 million, respectively. Rent expense for the nine months ended September 30, 2016 and 2015 was \$12.2 million and \$9.5 million, respectively.

Operating Covenants

To meet various states' licensing requirements and maintain accreditation by the Employer Services Assurance Corporation, the Company is subject to various minimum working capital and net worth requirements. As of September 30, 2016, the Company believes it has fully complied in all respects with all applicable state regulations regarding minimum net worth, working capital and all other financial and legal requirements. Further, the Company has maintained positive working capital throughout the period covered by the financial statements.

Contingencies

On or about August 7, 2015, Howard Welgus, a purported stockholder of the Company, filed a putative securities class action lawsuit arising under the Securities Exchange Act of 1934 in the United States District Court for the Northern District of California. The case has not been certified as a class action, although it purports to be filed on behalf of purchasers of the Company's common stock between May 5, 2014 and August 3, 2015, inclusive. The name of the case is Welgus v. TriNet Group, Inc. et al. No stockholder other than Mr. Welgus submitted a motion for appointment as lead plaintiff to represent the putative class, and, on December 3, 2015, the Court appointed Mr. Welgus as lead plaintiff. On February 1, 2016, Mr. Welgus filed a consolidated complaint. The defendants named in that complaint were the Company and certain of its officers and directors, as well as General Atlantic, LLC, a significant shareholder, and formerly majority shareholder, of the Company. Shortly before the scheduled date for the Company's motion to dismiss the consolidated complaint, Mr. Welgus sought leave to further amend the consolidated complaint. The amended complaint was deemed filed by Mr. Welgus on April 1, 2016. The amended complaint expanded the class period to March 27, 2014 through February 29, 2016, and added as defendants the underwriters of the Company's initial public offering and additional directors of the Company. The amended complaint generally alleges that the Company and other defendants caused damage to purchasers of the Company's stock by misrepresenting and/or failing to disclose facts generally pertaining to alleged trends affecting health insurance and workers compensation claims. On June 20, 2016, the Company filed a motion to dismiss the amended complaint in its entirety. On August 19, 2016, Mr. Welgus filed an opposition to the motion, which is now fully briefed and set for a hearing before the Court on November 3, 2016. The Company believes that it has meritorious defenses against this action and intends to continue to defend itself vigorously against the allegations of Mr. Welgus.

The Company is and, from time to time, has been and may in the future become involved in various litigation matters, legal proceedings and claims arising in the ordinary course of its business, including disputes with its clients or various class action, collective action, representative action and other proceedings arising from the nature of its co-employment relationship with its clients and WSEs in which the Company is named as a defendant. In addition, due to the nature of the Company's co-

employment relationship with its clients and WSEs, the Company could be subject to liability for federal and state law violations, even if the Company does not participate in such violations. While the Company's agreements with its clients contain indemnification provisions related to the conduct of its clients, the Company may not be able to avail itself of such provisions in every instance.

While the outcome of the matters described above cannot be predicted with certainty, management currently does not believe that any such claims or proceedings or the above mentioned securities class action will have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows. However, the unfavorable resolution of any particular matter or the Company's reassessment of its exposure for any of the above matters based on additional information obtained in the future could have a material impact on the Company's consolidated financial position, results of operations or cash flows. In addition, regardless of the outcome, the above matters, individually and in the aggregate, could have an adverse impact on the Company because of diversion of management resources and other factors.

NOTE 10. RELATED PARTY TRANSACTIONS

The Company enters into sales and purchases agreements with various companies that have a relationship with the Company's executive officers or members of the Company's board of directors. The relationships are typically an equity investment by the executive officer or board member in the customer / vendor company or the Company's executive officer or board member is a member of the customer / vendor company's board of directors. The Company has received \$5.7 million and \$3.3 million in total revenues from such related parties during the nine months ended September 30, 2016 and 2015, respectively.

The Company has entered into various software license agreements with a software service provider who has a board member in common with TriNet. The Company paid the software service provider \$6.1 million and \$4.1 million during the nine months ended September 30, 2016 and 2015, for services it received, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2015 previously filed with the Securities and Exchange Commission. When reviewing the discussion below, you should keep in mind the substantial risks and uncertainties that characterize our business. In particular, we also encourage you to review the risks and uncertainties described in the section titled "Risk Factors" included in our Annual Report on Form 10-K. Unless the context suggests otherwise, references to "TriNet," the "Company," "we," "us" and "our" refer to TriNet Group, Inc. and, where appropriate, its subsidiaries.

Special Note Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. 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," "plan," "project," "seek," "should," "strategy," "target," "will," "would" and similar expressions or variations thereof to identify forward-looking statements. These statements are not guarantees of future performance, but are based on management's expectations as of the date of this report and assumptions that are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements. Important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements include, but are not limited to, those identified below and those discussed in our risk factors disclosed in Part 1, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2015. All information provided in this report is as of the date of this report and the company undertakes no duty to update this information except as required by law.

Overview

TriNet is a leading provider of comprehensive HR solutions for small to midsize businesses under a co-employment model. Our HR solutions are designed to manage an increasingly complex set of HR regulations, costs, risks, and responsibilities for our clients, allowing them to focus on operating and growing their core businesses. Our bundled HR solutions include multi-state payroll processing and tax administration, employee benefits programs (including health insurance and retirement plans), workers compensation insurance and claims management, federal, state and local labor, employment and benefit law compliance, risk mitigation, expense and time management, and other human capital consulting services. Our proprietary, cloud-based HR software systems are used by our clients and their WSEs to efficiently store and manage their core HR-related information and conduct a variety of HR-related transactions anytime and anywhere. In addition, our expert teams of in-house HR professionals also provide additional services upon request to support various stages of our clients' growth, including talent management, recruiting and training, performance management consulting or other consulting services.

As of September 30, 2016, we served over 13,000 clients in all 50 states, the District of Columbia and Canada, and co-employed approximately 334,000 WSEs. Our clients are distributed across a variety of industries, including technology, life sciences, not-for-profit, professional services, financial services, property management, retail, manufacturing, and hospitality. Our sales and marketing, client services and product development teams are increasingly focused on specific industry verticals. This vertical approach gives us a deeper understanding of the HR needs facing SMBs in particular industries, which better enables us to provide HR solutions and services tailored to the specific needs of clients in these verticals. We conduct our business primarily in the United States.

For the three months ended September 30, 2016 and 2015, our total revenues were \$770.5 million and \$668.0 million, respectively. Our total revenues consist of professional service revenues and insurance service revenues. For each of the three months ended September 30, 2016 and 2015, 14% and 15% of our total revenues, respectively, consisted of professional service revenues, and 86% and 85% of our total revenues, respectively, consisted of insurance service revenues. For each of the nine months ended September 30, 2016 and 2015, 15% of our total revenues consisted of professional service revenues, and 85% of our total revenues consisted of insurance service revenues, respectively. We recognize as professional service revenues the fees we earn for providing our clients with a comprehensive suite of HR professional services, but do not include payroll amounts paid to us by clients as these are paid out to WSEs or

remitted to taxing and other authorities. We recognize as insurance service revenues all insurance-related billings and administrative fees collected from clients and withheld from WSEs. We pay premiums to third-party insurance carriers for client and WSE insurance benefits and reimburse the insurance carriers and third-party administrators for claims payments made on our behalf within our insurance deductible layer, where applicable. These premiums and reimbursements are classified as insurance costs on our statements of operations.

We sell our services primarily through our direct sales organization, which consists of sales representatives who focus on serving clients in specific industry vertical markets. For the three months ended September 30, 2016 and 2015, our sales and marketing expenses were \$41.5 million and \$45.0 million, respectively, or 5% and 7% of our total revenues, respectively, in each period, and 26% and 34% of our Net Service Revenues (as defined below) in such periods, respectively. For the nine months ended September 30, 2016 and 2015, our sales and marketing expenses were \$134.0 million and \$123.7 million, respectively, or 6% of our total revenues in each period and 28% and 31% of our Net Service Revenues in each period, respectively.

We have made significant investments in our proprietary, cloud-based HR systems, including implementing client information and management software to provide our clients with enhanced features and functionality. For the three months ended September 30, 2016 and 2015, our systems development and programming costs were \$8.1 million and \$7.0 million, respectively. For the nine months ended September 30, 2016 and 2015, our systems development and programming costs were \$21.0 million and \$21.8 million, respectively. For each of the three and nine months ended September 30, 2016, our systems development and programming costs were 1% of our total revenues and 5% and 4% of our Net Service Revenues, respectively. For each of the three and nine months ended September 30, 2015, our systems development and programming costs were 1% of our total revenues and 5% of our Net Service Revenues, respectively. We plan to continue to invest to upgrade and improve our technology offerings, including enhancements of our solutions to address specific needs of clients in our key vertical markets, as we believe the continued improvement of our technology provides TriNet with the ability to drive operating efficiencies while improving our clients' experience. We will leverage our existing online technology offerings to build additional products and features, including a full-service mobile platform, standard APIs for selected third party offerings, improved client experience for key processes, and retirement of legacy software systems from acquisitions and migration of clients to the primary TriNet software system.

Key Financial and Operating Metrics

We regularly review certain key financial and operating metrics to evaluate growth trends, measure our performance and make strategic decisions. These key financial and operating metrics may change over time. Our key financial and operating metrics as of and for the three and nine months ended September 30, 2016 and 2015 were as follows:

| Key Financial and Operating Metrics | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|-----------|---------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net Insurance Service Revenues (in thousands) | \$50,542 | \$34,054 | \$140,969 | \$103,627 |
| Net Service Revenues (in thousands) | \$161,035 | \$133,527 | \$473,458 | \$397,915 |
| Total WSEs | 333,778 | 314,930 | | |
| Total Sales Representatives | 406 | 479 | | |

Net Insurance Service Revenues and Net Service Revenues

We define Net Insurance Service Revenues as insurance service revenues less insurance costs. We define Net Service Revenues as the sum of professional service revenues and Net Insurance Service Revenues. Our total revenues on a GAAP basis represent the total amount invoiced by us to our clients, net of direct pass-through costs such as payroll and payroll tax payments, for the services we provide to our clients. Our insurance costs include the premiums we pay to third-party insurance carriers for the insurance coverage provided to our clients and WSEs and the reimbursements we pay to the insurance carriers and third-party administrators for claims payments made on our behalf within our insurance deductible layer, where applicable. We act principally as the service provider, adding value in the execution and procurement of these services to our clients. Net Insurance Service Revenues has served as the primary indicator of our ability to source, add value and offer benefit services to our clients and WSEs through third-party insurance carriers, and has been considered by management to be a key performance measure. Net Service Revenues has also served as a key performance measure as it provides a useful measure of total revenues for the two main components of our revenues calculated on a consistent basis. In addition, management believes measuring operating costs as a function of Net Service Revenues has historically provided a useful metric, as we believe it has enabled evaluation of the performance of our business. See "Non-GAAP Financial Results" for information regarding the limitations of using

Net Insurance Service Revenues and Net Service Revenues as financial measures and for a reconciliation to total revenues, the most directly comparable financial measure calculated in accordance with GAAP.

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Total WSEs

We define Total WSEs at the end of a given fiscal period as the total number of WSEs paid in the last calendar month of the fiscal period. Historically, comparing our Total WSEs at the end of a fiscal period to that of prior periods has served as an indicator of our success in growing our business, both organically and through the integration of acquired businesses, and retaining clients. While our Total WSEs paid in the last calendar month of the fiscal period has also historically been a leading indicator of our anticipated revenues for future fiscal periods, anticipated revenues for future fiscal periods can diverge from total WSEs paid due to pricing differences across our HR solutions and services.

Total Sales Representatives

Our direct sales force consists of sales representatives who focus on serving clients in specific industry vertical markets. We define Total Sales Representatives at the end of a given fiscal period as the total number of our direct sales force employees at that date. Historically, comparing our Total Sales Representatives at the end of a fiscal period to our Total Sales Representatives at the end of a prior fiscal period has served as an indicator of our success in growing our business. More recently, we have made efforts to improve the productivity of our sales force by establishing National Vertical Vice Presidents, individuals accountable for the entire sales performance of their assigned industry verticals. These leaders have consciously slowed down hiring while they assessed, recalibrated and realigned their teams. This led to the decrease in Total Sales Representatives for the nine months ended September 30, 2016. While having a productive direct sales force is important to the success of our business, we no longer rely on the absolute number of sales representatives by itself as an indicator of the growth of our revenues or our business overall.

Impact of Health Care Reform

The Affordable Care Act, or the Act, entails sweeping health care reforms with staggered effective dates from 2010 through 2020, and many provisions of the Act require the issuance of additional guidance from the U.S. Departments of Labor and Health and Human Services, the IRS and the states. A number of key provisions of the Act have begun to take effect over the past three years, including the establishment of state and federal insurance exchanges, insurance market reforms, “play or pay” penalties on applicable large employers and the imposition and assessment of excise taxes on the health insurance industry and reinsurance taxes on insurers and third-party administrators. Collectively, these items have the potential to significantly change the insurance marketplace for employers and how employers offer or provide insurance to employees. We are not yet able to determine the full impact to our business, and to our clients, resulting from the Act. In future periods, the Act may result in increased costs to us and our clients and could affect our ability to attract and retain clients. Additionally, we may be limited or delayed in our ability to increase service fees to offset any associated potential increased costs resulting from compliance with the Act. Furthermore, the uncertainty surrounding the terms and application of the Act may delay or inhibit the decisions of potential clients to outsource their HR needs. As a result, these changes could have a negative impact on our operating results.

Seasonality and Insurance Variability

Our business is affected by cyclical activity in business activity and WSE behavior. Historically, we have experienced our highest monthly addition of WSEs, as well as our highest monthly levels of client attrition, in the month of January, primarily because clients that change their payroll service providers tend to do so at the beginning of a calendar year. We also experience higher levels of client attrition in connection with renewals of the health insurance we sponsor for our WSEs, in the event that such renewals result in higher costs to our clients. We have also historically experienced higher insurance claim volumes in the second and third quarters of the year than in the first and fourth quarters, as WSEs typically access their health care providers more often in the second and third quarters, which has negatively impacted our insurance costs in these quarters. We have also experienced variability on a quarterly basis in the amount of our health and workers compensation insurance costs due to the number and severity of insurance claims being unpredictable. These historical trends may change, and other seasonal trends and variability may develop, which could make it more difficult for us to manage our business.

Non-GAAP Financial Results

We use Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income to provide an additional view of our operational performance. Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income are financial measures that are not prepared in accordance with GAAP.

We define Net Insurance Service Revenues as insurance service revenues less insurance costs, which include the premiums we pay to insurance carriers for the health and workers compensation insurance coverage provided to our clients and WSEs and the reimbursements we pay to the insurance carriers for claim payments within our insurance deductible layer. We define Net Service Revenues as the sum

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of professional service revenues and Net Insurance Service Revenues. We define Adjusted EBITDA as net income, excluding the effects of our income tax provision, interest expense, depreciation, amortization of intangible assets and stock-based compensation expense. We define Adjusted Net Income as net income, excluding the effects of our effective income tax rate, stock-based compensation, amortization of intangible assets, non-cash interest expense, and the income tax effect of these pre-tax adjustments at our effective tax rate. For purposes of our non-GAAP financial presentation, as a result of a 2015 increase in New York City tax rates and, in the third quarter of 2015, an increase in blended state rates, we have adjusted the effective tax rate to 42.5% for the three and nine month periods ended September 30, 2016, from 41.5% for three and nine month periods ended September 30, 2015. Each of these effective tax rates exclude income tax on non-deductible stock-based compensation and discrete items including the cumulative effect of state law changes. Non-cash interest expense represents amortization and write-off of our debt issuance costs. We believe that Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income are useful for our stockholders and board of directors by helping them to identify trends in our business and understand how our management evaluates our business. We believe that Net Insurance Service Revenues provides a useful measure of revenues from our provision of cost effective insurance services to our clients that eliminates the cost of insurance. We believe that Net Service Revenues provides a useful measure of total revenues for the two main components of our revenues calculated on a consistent basis. We believe that the use of Adjusted EBITDA and Adjusted Net Income provides useful period-to-period comparisons and analysis of trends in our business, as they exclude certain non-cash expenses. We use Net Insurance Service Revenues, Net Service Revenues and Adjusted EBITDA to monitor and evaluate our operating results and trends on an ongoing basis and internally for operating, budgeting and financial planning purposes, in addition to allocating our resources to enhance the financial performance of our business and evaluating the effectiveness of our business strategies. We also use Net Service Revenues and Adjusted EBITDA in determining the incentive compensation for management.

Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income are not prepared in accordance with, and should not be considered in isolation of, or as an alternative to, measurements required by GAAP. In addition, these non-GAAP measures are not based on any comprehensive set of accounting rules or principles. As non-GAAP measures, Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income have limitations in that they do not reflect all of the amounts associated with our results of operations as determined in accordance with GAAP. In particular:

- Net Insurance Service Revenues and Net Service Revenues are reduced by the insurance costs that we pay to the insurance carriers;
- Adjusted EBITDA does not reflect interest expense, or the cash requirements necessary to service interest or principal payments on our debt;
- Adjusted EBITDA does not reflect the amounts we paid in taxes or other components of our tax provision;
- Adjusted EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA and Adjusted Net Income do not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA and Adjusted Net Income do not reflect the non-cash component of employee compensation; Although depreciation and amortization of intangible assets are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements; and
- Other companies in our industry may calculate these measures or similar measures differently than we do, limiting their usefulness as a comparative measure.

Because of these limitations, you should consider Net Insurance Service Revenues, Net Service Revenues, Adjusted EBITDA and Adjusted Net Income alongside other financial performance measures, including total revenues, net income and our financial results presented in accordance with GAAP.

The table below sets forth a reconciliation of GAAP insurance service revenues to Net Insurance Service Revenues:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------|--|-----------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | | |
| Insurance service revenues | \$659,964 | \$568,535 | \$1,916,753 | \$1,639,305 |
| Less: Insurance costs | 609,422 | 534,481 | 1,775,784 | 1,535,678 |
| Net Insurance Service Revenues | \$50,542 | \$34,054 | \$140,969 | \$103,627 |

The table below sets forth a reconciliation of GAAP total revenues to Net Service Revenues:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------|--|-----------|------------------------------------|-------------|
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | | |
| Total revenues | \$770,457 | \$668,008 | \$2,249,242 | \$1,933,593 |
| Less: Insurance costs | 609,422 | 534,481 | 1,775,784 | 1,535,678 |
| Net Service Revenues | \$161,035 | \$133,527 | \$473,458 | \$397,915 |

The table below sets forth a reconciliation of GAAP net income to Adjusted EBITDA:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------|--|----------|------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | | |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |
| Provision for income taxes | 9,107 | 4,255 | 27,558 | 17,328 |
| Stock-based compensation | 6,264 | 4,188 | 20,169 | 12,991 |
| Interest expense and bank fees | 5,597 | 4,685 | 15,677 | 14,653 |
| Depreciation | 5,188 | 4,132 | 13,663 | 10,761 |
| Amortization of intangible assets | 4,662 | 10,459 | 14,647 | 32,284 |
| Adjusted EBITDA | \$45,399 | \$30,816 | \$130,154 | \$105,617 |

The table below sets forth a reconciliation of GAAP net income to Adjusted Net Income:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|----------|---------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | | |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |
| Effective income tax rate adjustment | (960) | 1,204 | (491) | 2,833 |
| Stock-based compensation | 6,264 | 4,188 | 20,169 | 12,991 |
| Amortization of intangible assets | 4,662 | 10,459 | 14,647 | 32,284 |
| Non-cash interest expense | 1,559 | 799 | 3,183 | 2,820 |
| Income tax impact of pre-tax adjustments | (5,306) | (6,410) | (16,150) | (19,959) |
| Adjusted Net Income | \$20,800 | \$13,337 | \$59,798 | \$48,569 |

Basis of Presentation and Key Components of Our Results of Operations

Total Revenues

Our total revenues consist of professional service revenues and insurance service revenues. For the three and nine months ended September 30, 2016, 14% and 15% of our total revenues consisted of professional service revenues and 86% and 85% of our total revenues consisted of insurance service revenues. For both the three and nine months ended September 30, 2015, 15% of our total revenues consisted of professional service revenues and 85% of our total revenues consisted of insurance service revenues.

We recognize as professional service revenues the fees we earn for providing our clients with a comprehensive suite of HR professional services, but do not include amounts paid to us by clients as payroll that are paid out to WSEs or amounts withheld and remitted to authorities as taxes. Our clients generally pay us these fees based on either a fixed fee per WSE per month or per transaction, or a percentage of the WSE's payroll cost, pursuant to written services agreements that are generally cancelable by us or our clients upon 30 days' prior written notice.

We recognize as insurance service revenues all insurance-related billings and administrative fees collected from clients and withheld from WSEs. We pay premiums to third-party insurance carriers for client and WSE insurance benefits and reimburse the insurance carriers and third-party administrators for claims payments made on our behalf within our insurance deductible layer, where applicable, as further described below in "Insurance Costs." These premiums and reimbursements are classified as insurance costs on our statements of operations.

Insurance Costs

Insurance costs include the premiums we pay to third-party insurance carriers for insurance coverage provided to clients and WSEs and the reimbursements we pay to the insurance carriers and third-party administrators for claims payments made on our behalf within the insurance deductible layer for those plans that have such a deductible. Our insurance costs are a function of the type and terms of agreements that we enter into with the third-party insurance carriers that provide Company-sponsored insurance plans for our clients and WSEs. Our future premiums for fully-insured policies with respect to which our carriers set the premiums and for which we were not responsible for any deductible, which are referred to as 'guaranteed cost' policies, will be influenced by the WSE claims activity in prior periods and rate increases by our insurance carriers. For fully-insured policies with respect to which we agree to reimburse our carriers for any claims paid within our agreed-upon deductible layer, WSEs file claims with the carriers. The carriers are responsible for paying the claims up to the maximum coverage under the policies. The carriers and third-party administrators then seek reimbursement from us for payments of claims made on our behalf up to our deductible per incident for workers compensation claims, or up to limits to our exposure for individual claims and limits to our maximum aggregate exposure for claims in a given policy year in accordance with the terms of the underlying health insurance policies. In no event are we liable to pay claims directly to WSEs. As we evaluate the claims experience for each fiscal period, we adjust, as we deem necessary, our workers compensation and health benefits reserves, and this in turn has a corresponding impact on our insurance costs. As a result, our insurance costs fluctuate from period to period depending on the number and severity of the claims incurred by our WSEs in that period and prior periods. We expect our insurance costs to continue to increase in absolute dollars on an annual basis for the foreseeable future due to expected growth in WSEs, which will likely mean an increase in the absolute number of claims, and an increase in the cost of claims due to inflation or other factors. Insurance costs may fluctuate as a percentage of revenue from period to period for these and other reasons.

Cost of Providing Services

Cost of providing services consists primarily of costs incurred by us associated with direct client support, such as payroll and benefits processing, professional HR consultants, employee liability insurance and costs associated with assisting clients in managing, processing and responding to employment-related legal claims, benefits and risk management, postage and shipping expenses and consulting expenses. We expect our cost of providing services to continue to increase in absolute dollars on an annual basis for the foreseeable future due to expected growth in WSEs, although we are working to improve our systems and processes and gain efficiencies. Our costs of providing services may fluctuate as a percentage of our total revenues from period to period depending on the timing of those expenses.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of salaries, commissions and related variable compensation expenses, commission payments to partners and the cost of marketing programs. Marketing programs consist of advertising, lead

generation, marketing events, corporate communications, brand building and product marketing activities, as well as various incentivized partnership and referral programs. We expect our sales and marketing expenses to increase in absolute dollars at a slower rate than in the past three years. Recent efforts to improve the productivity of our sales force have led to a slowdown in sales force hiring, reduction in the size of our direct sales force, and slowed the growth of marketing expenses. Our sales and marketing expenses may fluctuate as a percentage of our total revenues from period to period depending on the timing of those expenses.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation-related expenses, legal, accounting and other professional services fees and other general corporate expenses. We are working to improve our systems, processes and internal controls and to gain efficiencies. These expenses may fluctuate as a percentage of our total revenues from period to period depending on the timing of those expenses.

Systems Development and Programming Costs

Systems development and programming costs consist primarily of compensation-related expenses for our employees and contractors dedicated to systems development and programming, as well as fees that we pay to third-party consulting firms. We expect our investments in systems development and programming costs to continue to increase for the foreseeable future, which may include capital projects, as we continue to invest in and improve our technology platform. Our systems development and programming costs may fluctuate in absolute dollars and as a percentage of our total revenues from period to period depending on when we incur those costs and the mix of projects that are capital in nature.

Amortization of Intangible Assets

Amortization of intangible assets represents costs associated with an acquired company's developed technologies, client lists, trade names and contractual agreements. We amortize these intangibles over their respective estimated useful lives using either the straight-line method or the accelerated method.

Depreciation

Depreciation consists primarily of amortization of the cost of software and furniture, fixtures and equipment.

Other Income (Expense)

Other income (expense) consists primarily of interest expense under our credit facility and capital leases, and debt issuance cost amortization.

Provision for Income Taxes

We are subject to taxation in the United States and Canada. We conduct our business primarily in the United States, and almost all of our clients are U.S. employers with a small percentage of Canadian employers. We also provide services with respect to certain of our U.S. clients' employees in Canada. The percentage of our total revenues attributable to WSEs in Canada was less than 1% for each of three and nine months ended September 30, 2016 and 2015. Our effective tax rate differs from the statutory rate primarily due to state taxes, tax credits, non-deductible charges, changes in uncertain tax positions, and other discrete items. We make estimates and judgments about our future taxable income based on assumptions that are included in our plans. Should the actual amounts differ from our estimates, the amount of our valuation allowance could be materially affected.

Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Changes in valuation allowances are reflected as a component of provision for income taxes.

Results of Operations

The following tables set forth our results of operations for the periods presented and as a percentage of our total revenues and Net Service Revenues for those periods. Period-to-period comparisons of our financial results are not necessarily indicative of financial results to be achieved in future periods.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|-----------|
| | 2016 | 2015 | 2016 | 2015 |
| Consolidated Statement of Operations: | | | | |
| | (in thousands) | | | |
| Professional service revenues | \$110,493 | \$99,473 | \$332,489 | \$294,288 |
| Insurance service revenues | 659,964 | 568,535 | 1,916,753 | 1,639,305 |
| Total revenues | 770,457 | 668,008 | 2,249,242 | 1,933,593 |
| Costs and operating expenses: | | | | |
| Insurance costs | 609,422 | 534,481 | 1,775,784 | 1,535,678 |
| Cost of providing services (exclusive of depreciation and amortization of intangible assets) ⁽¹⁾ | 50,142 | 37,540 | 139,881 | 111,582 |
| Sales and marketing ⁽¹⁾ | 41,470 | 44,997 | 133,978 | 123,740 |
| General and administrative ⁽¹⁾ | 22,477 | 17,726 | 69,078 | 48,991 |
| Systems development and programming costs ⁽¹⁾ | 8,124 | 6,991 | 20,970 | 21,849 |
| Amortization of intangible assets | 4,662 | 10,459 | 14,647 | 32,284 |
| Depreciation | 5,188 | 4,132 | 13,663 | 10,761 |
| Total costs and operating expenses | 741,485 | 656,326 | 2,168,001 | 1,884,885 |
| Operating income | 28,972 | 11,682 | 81,241 | 48,708 |
| Other income (expense): | | | | |
| Interest expense and bank fees | (5,597) | (4,685) | (15,677) | (14,653) |
| Other, net | 313 | 355 | 434 | 873 |
| Income before provision for income taxes | 23,688 | 7,352 | 65,998 | 34,928 |
| Provision for income taxes | 9,107 | 4,255 | 27,558 | 17,328 |
| Net income | \$14,581 | \$3,097 | \$38,440 | \$17,600 |

(1) Includes stock-based compensation expense as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|---------|---------------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| | (in thousands) | | | |
| Cost of providing services | \$1,605 | \$1,079 | \$5,044 | \$3,051 |
| Sales and marketing | 1,491 | 1,029 | 5,119 | 3,255 |
| General and administrative | 2,544 | 1,633 | 8,161 | 5,497 |
| Systems development and programming costs | 624 | 447 | 1,845 | 1,188 |
| Total stock-based compensation expense | \$6,264 | \$4,188 | \$20,169 | \$12,991 |

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2016 | | Three Months Ended September 30, 2015 | | Nine Months Ended September 30, 2015 | |
|--|---------------------------------------|----|--------------------------------------|----|---------------------------------------|----|--------------------------------------|----|
| Percentage of total revenues: | | | | | | | | |
| Professional service revenues | 14 | % | 15 | % | 15 | % | 15 | % |
| Insurance service revenues | 86 | % | 85 | % | 85 | % | 85 | % |
| Total revenues | 100 | % | 100 | % | 100 | % | 100 | % |
| Costs and operating expenses: | | | | | | | | |
| Insurance costs | 79 | % | 80 | % | 79 | % | 79 | % |
| Cost of providing services (exclusive of depreciation and amortization of intangible assets) | 7 | % | 6 | % | 6 | % | 6 | % |
| Sales and marketing | 5 | % | 7 | % | 6 | % | 6 | % |
| General and administrative | 3 | % | 3 | % | 3 | % | 3 | % |
| Systems development and programming costs | 1 | % | 1 | % | 1 | % | 1 | % |
| Amortization of intangible assets | 1 | % | 2 | % | 1 | % | 2 | % |
| Depreciation | 1 | % | 1 | % | 1 | % | 1 | % |
| Total costs and operating expenses | 96 | % | 98 | % | 96 | % | 97 | % |
| Operating income | 4 | % | 2 | % | 4 | % | 3 | % |
| Other income (expense): | | | | | | | | |
| Interest expense and bank fees | (1) |)% | (1) |)% | (1) |)% | (1) |)% |
| Other, net | 0 | % | 0 | % | 0 | % | 0 | % |
| Income before provision for income taxes | 3 | % | 1 | % | 3 | % | 2 | % |
| Provision for income taxes | 1 | % | 1 | % | 1 | % | 1 | % |
| Net income | 2 | % | 0 | % | 2 | % | 1 | % |

| | Three Months Ended September 30, 2016 | | Nine Months Ended September 30, 2016 | | Three Months Ended September 30, 2015 | | Nine Months Ended September 30, 2015 | |
|--|---------------------------------------|----|--------------------------------------|----|---------------------------------------|----|--------------------------------------|----|
| Percentage of Net Service Revenues: | | | | | | | | |
| Professional service revenues | 69 | % | 74 | % | 70 | % | 74 | % |
| Net Insurance Service Revenues | 31 | % | 26 | % | 30 | % | 26 | % |
| Net Service Revenues | 100 | % | 100 | % | 100 | % | 100 | % |
| Other operating expenses: | | | | | | | | |
| Cost of providing services (exclusive of depreciation and amortization of intangible assets) | 31 | % | 28 | % | 30 | % | 28 | % |
| Sales and marketing | 26 | % | 34 | % | 28 | % | 31 | % |
| General and administrative | 14 | % | 13 | % | 15 | % | 12 | % |
| Systems development and programming costs | 5 | % | 5 | % | 4 | % | 5 | % |
| Amortization of intangible assets | 3 | % | 8 | % | 3 | % | 8 | % |
| Depreciation | 3 | % | 3 | % | 3 | % | 3 | % |
| Total other operating expenses | 82 | % | 91 | % | 83 | % | 88 | % |
| Operating income | 18 | % | 9 | % | 17 | % | 12 | % |
| Other income (expense): | | | | | | | | |
| Interest expense and bank fees | (3) |)% | (4) |)% | (3) |)% | (4) |)% |
| Other, net | 0 | % | 0 | % | 0 | % | 0 | % |
| Income before provision for income taxes | 15 | % | 6 | % | 14 | % | 9 | % |
| Provision for income taxes | 6 | % | 3 | % | 6 | % | 4 | % |

Net income

9 % 2 % 8 % 4 %

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Three and Nine Months Ended September 30, 2016 and 2015

Total Revenues

| | Three Months Ended September 30, | | Change 2016 vs. 2015 | | Nine Months Ended September 30, | | Change 2016 vs. 2015 | |
|-------------------------------|------------------------------------|------------|----------------------|-----|---------------------------------|--------------|----------------------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (in thousands, except percentages) | | | | | | | |
| Professional service revenues | \$ 110,493 | \$ 99,473 | \$ 11,020 | 11% | \$ 332,489 | \$ 294,288 | \$ 38,201 | 13% |
| Insurance service revenues | 659,964 | 568,535 | 91,429 | 16% | 1,916,753 | 1,639,305 | 277,448 | 17% |
| Total revenues | \$ 770,457 | \$ 668,008 | \$ 102,449 | 15% | \$ 2,249,242 | \$ 1,933,593 | \$ 315,649 | 16% |

Key operating metrics:

| | | | | |
|-----------------------------|---------|---------|--------|-------|
| Total WSEs | 333,778 | 314,930 | 18,848 | 6% |
| Total Sales Representatives | 406 | 479 | (73) | (15)% |

Total revenues increased by \$102.4 million, or 15%, for the three months ended September 30, 2016 compared to the same period of the prior year, and by \$315.6 million, or 16%, for the nine months ended September 30, 2016 compared to the same period of the prior year. For the three and nine months ended September 30, 2016, 14% and 15% of our total revenues consisted of professional service revenues, and 86% and 85% of our total revenues consisted of insurance service revenues.

Professional service revenues increased by \$11.0 million, or 11%, for the three months ended September 30, 2016 compared to the same period of the prior year. The increase was mainly attributable to our increase in WSEs and an increase of 5% in average revenue per WSE. Professional service revenues increased by \$38.2 million, or 13%, for the nine months ended September 30, 2016 compared to the same period of the prior year. The increase was mainly attributable to our increase in WSEs and an increase of 4% in average revenue per WSE.

Insurance service revenues increased by \$91.4 million, or 16%, for the three months ended September 30, 2016 compared to the same period of the prior year. The increase was mainly attributable to our increase in WSEs and an increase of 9% in average revenue per WSE. Insurance service revenues increased by \$277.4 million, or 17%, for the nine months ended September 30, 2016 compared to the same period of the prior year. The increase was mainly attributable to our increase in WSEs and an increase of 8% in average revenue per WSE.

Total WSEs at September 30, 2016 increased by 18,848, or 6%, compared to Total WSEs at September 30, 2015, which was primarily driven by a net increase in total clients. Our Total Sales Representatives decreased from 479 at September 30, 2015 to 406 at September 30, 2016, primarily due to our efforts to improve the efficiency of our sales force.

Insurance Costs

| | Three Months Ended September 30, | | Change 2016 vs. 2015 | | Nine Months Ended September 30, | | Change 2016 vs. 2015 | |
|-----------------|------------------------------------|------------|----------------------|-----|---------------------------------|--------------|----------------------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (in thousands, except percentages) | | | | | | | |
| Insurance costs | \$ 609,422 | \$ 534,481 | \$ 74,941 | 14% | \$ 1,775,784 | \$ 1,535,678 | \$ 240,106 | 16% |

Insurance costs increased \$74.9 million, or 14%, for the three months ended September 30, 2016, compared to the same period of the prior year. The increase resulted from an increase in WSEs and an increase of 7% in average insurance cost per WSE for the three months ended September 30, 2016, primarily due to increased medical costs per WSE. Insurance costs increased \$240.1 million, or 16%, for the nine months ended September 30, 2016, compared to the same period of the prior year. The increase resulted from an increase in WSEs and an increase of 6% in average insurance cost per WSE for the nine months ended September 30, 2016, primarily due to increased medical costs per WSE, partially offset by decreased workers compensation costs per WSE.

Net Insurance Service Revenues and Net Service Revenues

| | Three Months Ended September 30, | | Change 2016 vs. 2015 | | Nine Months Ended September 30, | | Change 2016 vs. 2015 | |
|--------------------------------|------------------------------------|-----------|----------------------|-----|---------------------------------|-------------|----------------------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (in thousands, except percentages) | | | | | | | |
| Insurance service revenues | \$659,964 | \$568,535 | \$91,429 | 16% | \$1,916,753 | \$1,639,305 | \$277,448 | 17% |
| Less: Insurance costs | 609,422 | 534,481 | 74,941 | 14% | 1,775,784 | 1,535,678 | 240,106 | 16% |
| Net Insurance Service Revenues | \$50,542 | \$34,054 | \$16,488 | 48% | \$140,969 | \$103,627 | \$37,342 | 36% |

| | Three Months Ended September 30, | | Change 2016 vs. 2015 | | Nine Months Ended September 30, | | Change 2016 vs. 2015 | |
|-----------------------|------------------------------------|-----------|----------------------|-----|---------------------------------|-------------|----------------------|-----|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| | (in thousands, except percentages) | | | | | | | |
| Total revenues | \$770,457 | \$668,008 | \$102,449 | 15% | \$2,249,242 | \$1,933,593 | \$315,649 | 16% |
| Less: Insurance costs | 609,422 | 534,481 | 74,941 | 14% | 1,775,784 | 1,535,678 | 240,106 | 16% |
| Net Service Revenues | \$161,035 | \$133,527 | \$27,508 | 21% | \$473,458 | \$397,915 | \$75,543 | 19% |

For the reasons described in our insurance service revenues and costs commentary, our Net Insurance Service Revenues increased by \$16.5 million, or 48%, for the three months ended September 30, 2016 as compared to the same period of the prior year, and by \$37.3 million, or 36%, for the nine months ended September 30, 2016 as compared to the same period of the prior year. Our Net Service Revenues increased by \$27.5 million, or 21%, for the three months ended September 30, 2016 as compared to the same period of the prior year, and increased by \$75.5 million, or 19%, for the nine months ended September 30, 2016 as compared to the same period of the prior year.

Other Operating Expenses

| | Three Months Ended September 30, | | Change 2016 vs. 2015 | | Nine Months Ended September 30, | | Change 2016 vs. 2015 | |
|--|----------------------------------|-----------|----------------------|-------|---------------------------------|-----------|----------------------|-------|
| | 2016 | 2015 | \$ | % | 2016 | 2015 | \$ | % |
| Cost of providing services (exclusive of depreciation and amortization of intangible assets) | \$50,142 | \$37,540 | \$12,602 | 34% | \$139,881 | \$111,582 | \$28,299 | 25% |
| Sales and marketing | 41,470 | 44,997 | (3,527) | (8)% | 133,978 | 123,740 | 10,238 | 8% |
| General and administrative | 22,477 | 17,726 | 4,751 | 27% | 69,078 | 48,991 | 20,087 | 41% |
| Systems development and programming costs | 8,124 | 6,991 | 1,133 | 16% | 20,970 | 21,849 | (879) | (4)% |
| Amortization of intangible assets | 4,662 | 10,459 | (5,797) | (55)% | 14,647 | 32,284 | (17,637) | (55)% |
| Depreciation | 5,188 | 4,132 | 1,056 | 26% | 13,663 | 10,761 | 2,902 | 27% |
| Total operating expenses | \$132,063 | \$121,845 | \$10,218 | 8% | \$392,217 | \$349,207 | \$43,010 | 12% |

Cost of Providing Services

Cost of providing services increased by \$12.6 million, or 34%, for the three months ended September 30, 2016 compared to the same period of the prior year. The increase was primarily attributable to a \$5.0 million increase in compensation-related costs due to increased headcount to support our growth. Additionally, our tax and compliance costs increased \$5.2 million. Consulting costs increased \$1.9 million primarily related to review and administration of our insurance programs. Cost of providing services represented 7% and 6% of total revenues in each of the three

months ended September 30, 2016 and 2015, respectively. As a percentage of Net Service Revenues, cost of providing services expenses increased to 31% in the three months ended September 30, 2016, from 28% in the same period of the prior year.

Cost of providing services increased by \$28.3 million, or 25%, for the nine months ended September 30, 2016 compared to the same period of the prior year. The increase was primarily attributable to a \$14.6 million increase in compensation-related costs due to increased headcount to support our growth. Additionally, our tax and compliance costs increased \$5.2 million. Costs associated with our employment insurance offering to WSEs increased \$1.6 million and consulting costs increased \$5.1 million primarily related to review and administration of our insurance programs. Cost of providing services represented 6% of total revenues in each of the nine months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, cost of providing services expenses increased to 30% in the nine months ended September 30, 2016, from 28% in the same period of the prior year.

Sales and Marketing

Sales and marketing expenses for the three months ended September 30, 2016 decreased by \$3.5 million, or 8%, compared to the same period of the prior year. This decrease was due to reduced compensation and travel and entertaining related costs from a reduction in Total Sales Representatives. Sales and marketing expenses represented 5% and 7% of total revenue in each of the three months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, sales and marketing expenses decreased to 26% in the three months ended September 30, 2016, from 34% in the same period of the prior year.

Sales and marketing expenses for the nine months ended September 30, 2016 increased by \$10.2 million, or 8%, compared to the same period of the prior year. Of this increase, \$10.5 million was due to compensation-related costs from investments to improve our sales productivity. Sales and marketing expenses represented 6% of total revenues in each of the nine months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, sales and marketing expenses decreased to 28% in the nine months ended September 30, 2016, from 31% in the same period of the prior year.

General and Administrative

General and administrative expenses for the three months ended September 30, 2016 increased by \$4.8 million, or 27%, compared to the same period of the prior year. Compensation-related costs increased \$4.0 million compared to the same period of the prior year as a result of increased headcount to support the operational and compliance requirements of a growing public company. General and administrative expenses represented 3% of total revenues in each of the three months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, general and administrative expenses increased to 14% in the three months ended September 30, 2016, from 13% in the same period of the prior year.

General and administrative expenses for the nine months ended September 30, 2016 increased by \$20.1 million, or 41%, compared to the same period of the prior year. Compensation-related costs increased \$11.2 million compared to the same period of the prior year as a result of increased headcount to support the operational and compliance requirements of a growing public company. Accounting and other professional fees increased \$8.0 million primarily due to significant additional time and resources associated with the audit of our internal controls as required by Section 404 of the Sarbanes-Oxley Act. General and administrative expenses represented 3% of total revenues in each of the nine months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, general and administrative expenses increased to 15% for the nine months ended September 30, 2016 from 12% in the same period of the prior year.

Systems Development and Programming

Our systems development and programming costs for the three months ended September 30, 2016 increased by \$1.1 million, or 16%, compared to the same period of the prior year. Compensation-related costs increased \$1.1 million compared to the same period of the prior year due to increased headcount to support and enhance our products and platform. Systems development and programming costs represented 1% of total revenues in each of the three months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, systems development and programming represented 5% in each of the three months ended September 30, 2016 and 2015.

Our systems development and programming costs for the nine months ended September 30, 2016 decreased by \$0.9 million, or 4%, compared to the same period of the prior year. The decrease was primarily due to an increase in capitalized wages to support and enhance our products and platform, partially offset by an increase in compensation related costs due to increased headcount. Systems development and programming costs represented 1% of total revenues in each of the nine months ended September 30, 2016 and 2015. As a percentage of Net Service Revenues, systems development and

programming costs decreased to 4% for the nine months ended September 30, 2016 from 5% in the same period of the prior year.

Amortization of Intangible Assets and Depreciation

Our amortization of intangible assets decreased by \$5.8 million, or 55%, for the three months ended September 30, 2016 compared to the same period of the prior year, and by \$17.6 million, or 55%, for the nine months ended September 30, 2016 compared to the same period of the prior year. These decreases were primarily resulted from the expiration of useful lives of certain customer lists and non-compete agreements related to our previous acquisitions.

Our depreciation costs increased by \$1.1 million, or 26%, for the three months ended September 30, 2016 compared to the same period of the prior year, and by \$2.9 million, or 27%, for the nine months ended September 30, 2016 compared to the same period of the prior year. These increases were primarily attributable to capitalized software.

Provision for Income Taxes

Our provision for income taxes for the three months ended September 30, 2016 increased by \$4.9 million compared to the same period of the prior year, primarily due to the increase in our pre-tax income. Our effective income tax rate decreased from 57.9% for the three months ended September 30, 2015 to 38.4% for the three months ended September 30, 2016, primarily due to an expense recorded in 2015 for the revaluation of deferred taxes resulting from state legislative changes and discrete benefits recorded in 2016 for disqualifying dispositions of previously non-deductible stock based compensation and prior year state income tax adjustments.

Our provision for income taxes for the nine months ended September 30, 2016 increased by \$10.2 million compared to the same period of the prior year, primarily due to the increase in our pre-tax income. Our effective income tax rate decreased from 49.6% for the nine months ended September 30, 2015 to 41.8% for the nine months ended September 30, 2016 primarily due to an expense recorded in 2015 for the revaluation of deferred taxes resulting from state legislative changes and discrete benefits recorded in 2016 associated with disqualifying dispositions of previously non-deductible stock- based compensation and prior year state income tax adjustments.

Liquidity and Capital Resources

Our principal source of liquidity for operations is derived from cash provided by operating activities. We rely on cash provided by operating activities to meet our short-term liquidity requirements, which primarily relate to the payment of corporate payroll and other operating costs, and capital expenditures. Our credit facilities have been used to fund acquisitions and special dividends, and we have not relied on these facilities to provide liquidity for our operations. Our cash flow related to WSE payroll and benefits is generally matched by advance collection from our clients. To minimize the credit risk associated with remitting the payroll and associated taxes and benefits costs, we require clients to prefund the payroll and related payroll taxes and benefits costs. To the extent this does not occur, our results of operations and cash flow may be negatively impacted.

WSE-related liabilities can fluctuate significantly due to various factors, including the day of the week on which a client payroll period ends, the existence of holidays at or immediately following a client payroll period-end and various federal and state compliance calendars. We report the advance collection from our clients as payroll funds collected within WSE-related assets on our balance sheet. Our cash and cash equivalents reported on our balance sheet represent our corporate cash available to meet corporate liquidity requirements, capital spending and expansion plans, potential acquisitions, stock repurchases, debt service requirements and other corporate cash needs and initiatives.

Cash Flows

We generated positive cash flows from operating activities during the nine months ended September 30, 2016 and 2015. We also have the ability to generate cash through our financing arrangements under our credit facility to meet short-term funding requirements related to WSE-related obligations. The following table shows our cash flows from operating activities, investing activities and financing activities for the stated periods:

| | Nine Months Ended | |
|---|-------------------|-----------|
| | September 30, | |
| | 2016 | 2015 |
| | (in thousands) | |
| Net cash provided by (used in): | | |
| Operating activities | \$78,108 | \$104,521 |
| Investing activities | (17,411) | (33,211) |
| Financing activities | (66,407) | (59,097) |
| Effect of exchange rates on cash and cash equivalents | 90 | (239) |
| Net increase (decrease) in cash and cash equivalents | \$(5,620) | \$11,974 |

Cash Flows from Operating Activities

Net cash provided by operating activities was \$78.1 million and \$104.5 million for the nine months ended September 30, 2016 and 2015, respectively. The decrease is primarily due to income taxes paid and workers compensation collateral paid to carriers.

Cash Flows from Investing Activities

Net cash used in investing activities was \$17.4 million for the nine months ended September 30, 2016, as compared to \$33.2 million in the same period of the prior year. Net cash used in investing activities during the nine months ended September 30, 2016 was attributable to \$27.9 million in purchases of property and equipment and \$15.0 million in purchases of debt securities, partially offset by \$25.8 million in maturity of debt securities in our investment portfolio. Net cash used in investing activities during the nine months ended September 30, 2015 consisted of \$15.0 million in purchases of debt securities, \$14.7 million to purchase property and equipment and \$4.8 million in acquisitions of businesses.

Cash Flows from Financing Activities

Net cash used in financing activities was \$66.4 million for the nine months ended September 30, 2016, compared to \$59.1 million in the same period of the prior year. Net cash used in financing activities during the nine months ended September 30, 2016 was primarily attributable to \$57.6 million in payments for extinguishment of debt, offset by \$58.0 million in borrowings under notes payable as a result of refinancing as described in Note 5. There was also \$43.7 million of stock repurchases and \$27.5 million in repayments of notes payable. Net cash used in financing activities during the nine months ended September 30, 2015 primarily consisted of \$48.4 million in stock repurchases and \$40.5 million in loan repayments, offset by excess tax credits of \$20.3 million from equity incentive plan activity.

Contractual Obligations

The following table summarizes our contractual obligations as of September 30, 2016, and the effect they are expected to have on our liquidity and capital resources (in thousands):

| | Payments Due by Period | | | | |
|--|------------------------|--------------------------|------------------|------------------|-------------------------|
| | Total | Remaining fiscal year | 1-3 years | 3-5 years | More than 5 years |
| Notes payable | \$472,500 | \$ 9,563 | \$79,688 | \$383,249 | \$— |
| Interest on notes payable | 38,994 | 3,808 | 28,435 | 6,751 | — |
| Workers compensation claim liabilities | 285,136 | 99,711 | 86,545 | 37,096 | 61,784 |
| Capital lease obligations | 205 | 20 | 145 | 40 | — |
| Operating lease obligations | 63,895 | 3,591 | 26,486 | 22,349 | 11,469 |
| Purchase obligations | 15,906 | 896 | 14,488 | 522 | — |
| Uncertain tax positions | 565 | 20 | 545 | — | — |
| Total | \$877,201 | \$ 117,609 | \$236,332 | \$450,007 | \$73,253 |

Notes payable and related interest reflect the terms of the Amended and Restated Credit Agreement discussed above.

The projected interest payments incorporate the forward LIBOR curve as of September 30, 2016.

Workers compensation liabilities represented in the table above are considered contractual obligations because they represent the estimated payments that are expected to be made to carriers for the various workers compensation programs. These obligations include the costs of reimbursing the carriers for paying claims within the deductible layer in accordance with workers compensation insurance policies as well as premiums and other liabilities. Workers compensation claim liabilities include estimates for reported claims, plus estimates for claims incurred but not reported, and estimates of certain expenses associated with processing and settling the claims. These estimates are subject to significant uncertainty. The actual amount to be paid is not finally determined until we reach a settlement with the insurance carrier. Final claim settlements may vary significantly from the present estimates, particularly because many claims will not be settled until well into the future. In estimating the timing of future payments by year, we have assumed that our historical payment patterns will continue. However, the actual timing of future payments could vary materially from these estimates due to, among other things, changes in claim reporting and payment patterns and large unanticipated settlements.

Our purchase obligations primarily consist of software licenses and maintenance, sales and marketing events and professional and consulting fees. These are associated with agreements that we believe are enforceable and legally binding and that specify all significant terms, including fixed or minimum services to be used, fixed, minimum or variable price provisions, and the approximate timing of the transaction.

To support our growth and expansion, we may lease additional office space. Many of our operating lease agreements provide us with the option to renew. Our future operating lease obligations would change if we exercised these options and if we entered into additional operating lease agreements as we expand our operations.

In the normal course of business, we make representations and warranties that guarantee the performance of services under service arrangements with clients. Historically, there has been no material losses related to such guarantees. In addition, in connection with our initial public offering, we have entered into indemnification agreements with our officers and directors, which require us to defend and, if necessary, indemnify these individuals for certain pending or future legal claims as they relate to their services provided to us. Such indemnification obligations are not included in the table above.

The uncertain tax positions disclosed in the table above exclude certain tax credit related reserves that we net with tax credit carryforwards. The reserve on these tax credits does not represent a contractual obligation or commitment because the associated tax credits have not been utilized to offset our tax liability.

Off-Balance Sheet Arrangements

The Company had no material off-balance sheet arrangements at September 30, 2016.

Critical Accounting Policies, Estimates and Judgments

There have been no material changes to our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

See Note 1 to the Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Other than the item discussed below, there has been no material change in our exposure to market risks from that discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2015.

We had total outstanding indebtedness of \$472.5 million as of September 30, 2016, of which \$38.3 million is due within 12 months. We are exposed to market risk from changes in interest rates on our debt. Depending upon the borrowing option chosen, the interest charged is generally based upon the prime lending rate or LIBOR plus an applicable margin. If interest rates in effect at September 30, 2016 increased 100 basis points, our interest expense for 2016 through 2019 would be increased by \$11.9 million. On the other hand, if interest rates in effect at December 31, 2015 decreased 100 basis points, our interest expense for 2016 through 2019 would be decreased by \$11.9 million.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of September 30, 2016, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were not effective as a result of the material weaknesses in our internal control over financial reporting.

However, giving full consideration to these weaknesses, and the additional analyses and other procedures we performed to ensure that our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), our management has concluded that our condensed consolidated financial statements present fairly, in all material respects, our financial position, results of operations and cash flows for the periods disclosed in conformity with GAAP.

Additional Analyses and Procedures and Remediation Plan

We are taking specific steps to remediate the material weaknesses identified by management and described in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2015. Although we intend to complete the remediation process with respect to these material weaknesses as quickly as possible, we cannot at this time estimate how long it will take, and our remediation plan may not prove to be successful.

Because the reliability of the internal control process requires repeatable execution, the successful remediation of these material weaknesses will require review and evidence of effectiveness prior to concluding that the controls are effective and there is no assurance that additional remediation steps will not be necessary. As such, as we continue to evaluate and work to improve our internal control over financial reporting, our management may decide to take additional measures to address the material weaknesses or modify the remediation steps already underway. As noted above, although we plan to complete the remediation process as quickly as possible, we cannot at this time estimate how long it will take, and our initiatives may not prove to be successful. Accordingly, until these weaknesses are remediated, we plan to perform additional analyses and other procedures to ensure that our consolidated financial statements are prepared in accordance with GAAP.

Changes in Internal Control Over Financial Reporting

Other than the remediation efforts underway, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that

occurred during the quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating the disclosure controls and procedures, management recognizes that any 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 judgment in evaluating the benefits of possible controls and procedures relative to their costs.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

Securities Class Action. On or about August 7, 2015, Howard Welgus, a purported stockholder of the Company, filed a putative securities class action lawsuit arising under the Securities Exchange Act of 1934 in the United States District Court for the Northern District of California. The case has not been certified as a class action, although it purports to be filed on behalf of purchasers of the Company's common stock between May 5, 2014 and August 3, 2015, inclusive. The name of the case is Welgus v. TriNet Group, Inc. et al. No stockholder other than Mr. Welgus submitted a motion for appointment as lead plaintiff to represent the putative class, and, on December 3, 2015, the Court appointed Mr. Welgus as lead plaintiff. On February 1, 2016, Mr. Welgus filed a consolidated complaint. The defendants named in that complaint were the Company and certain of its officers and directors, as well as General Atlantic, LLC, a significant shareholder, and formerly majority shareholder, of the Company. Shortly before the scheduled date for the Company's motion to dismiss the consolidated complaint, Mr. Welgus sought leave to further amend the consolidated complaint. The amended complaint was deemed filed by Mr. Welgus on April 1, 2016. The amended complaint expanded the class period to March 27, 2014 through February 29, 2016, and added as defendants the underwriters of the Company's initial public offering and additional directors of the Company. The amended complaint generally alleges that the Company and other defendants caused damage to purchasers of the Company's stock by misrepresenting and/or failing to disclose facts generally pertaining to alleged trends affecting health insurance and workers compensation claims. On June 20, 2016, the Company filed a motion to dismiss the amended complaint in its entirety. On August 19, 2016, Mr. Welgus filed an opposition to the motion, which is now fully briefed and set for a hearing before the Court on November 3, 2016. The Company believes that it has meritorious defenses against this action and intends to continue to defend itself vigorously against the allegations of Mr. Welgus.

Other Litigation. The Company is and, from time to time, has been and may in the future become involved in various litigation matters, legal proceedings and claims arising in the ordinary course of its business, including disputes with its clients or various class action, collective action, representative action and other proceedings arising from the nature of its co-employment relationship with its clients and WSEs in which the Company is named as a defendant. In addition, due to the nature of the Company's co-employment relationship with its clients and WSEs, the Company could be subject to liability for federal and state law violations, even if the Company does not participate in such violations. While the Company's agreements with its clients contain indemnification provisions related to the conduct of its clients, the Company may not be able to avail itself of such provisions in every instance.

While the outcome of the matters described above cannot be predicted with certainty, management currently does not believe that any such claims or proceedings or the above mentioned securities class action will have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows. However, the unfavorable resolution of any particular matter or the Company's reassessment of its exposure for any of the above matters based on additional information obtained in the future could have a material impact on the Company's consolidated financial position, results of operations or cash flows. In addition, regardless of the outcome, the above matters, individually and in the aggregate, could have an adverse impact on the Company because of diversion of management resources and other factors.

Item 1A. Risk Factors

There have been no material changes in our risk factors disclosed in Part 1, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2015.

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

(a) Sales of Unregistered Securities

Not applicable.

(b) Issuer Purchases of Equity Securities

The following table provides information about our purchases of TriNet common stock during the quarter ended September 30, 2016:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (1) | Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans (1) |
|----------------------------------|----------------------------------|------------------------------|--|--|
| July 1 - July 31, 2016 | 362,440 | \$ 21.67 | 362,346 | \$ 57,317,447 |
| August 1 - August 31, 2016 | 330,909 | \$ 21.29 | 275,765 | \$ 51,464,834 |
| September 1 - September 30, 2016 | 651,447 | \$ 20.88 | 650,210 | \$ 37,881,498 |
| Total | 1,344,796 | | | |

In May 2014, our board of directors authorized a program to repurchase in the aggregate up to \$15 million of our outstanding common stock. Our board of directors subsequently approved incremental increases to our ongoing stock repurchase program of \$30 million in November 2014, \$50 million in June 2015 and \$50 million in February (1) 2016. In 2014 and 2015, we repurchased approximately \$15 million and approximately \$49.2 million, respectively, of our outstanding common stock. As of September 30, 2016 we had approximately \$37.9 million remaining for repurchases under our stock repurchase program. Stock repurchases under the program are primarily intended to offset the dilutive effect of share-based employee incentive compensation.

Item 3. Defaults Upon Senior Securities.

Not applicable

Item 4. Mine Safety Disclosures.

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

A list of exhibits filed with this report or incorporated herein by reference is found in the Exhibit Index immediately following the signature page of this report and is incorporated into this Item 6 by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TRINET GROUP, INC.

Date: November 3, 2016 By: /s/ Burton M. Goldfield
Burton M. Goldfield
Chief Executive Officer

Date: November 3, 2016 By: /s/ William Porter
William Porter
Chief Financial Officer

EXHIBIT INDEX

| Exhibit No. | Exhibit | Incorporated by Reference | | | Filed Herewith |
|-------------|---|---------------------------|-----------|---------------------|----------------|
| | | Form | File No. | Exhibit Filing Date | |
| 10.1 | Incremental Facility Amendment, dated as of July 29, 2016, to the Amended and Restated First Lien Credit Agreement, dated as of August 20, 2013, as amended and restated as of July 9, 2014, among TriNet HR Corporation, as borrower, TriNet Group, Inc., the lenders from time to time party thereto and JPMorgan Chase Bank, N.A., as administrative agent | 8-K | 001-36373 | 10.1 08/01/2016 | |
| 10.2* | Transition Agreement by and among TriNet Group, Inc. and William Porter, dated as of September 30, 2016. | 8-K | 001-36373 | 10.1 10/03/2016 | |
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | X |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | | | | X |
| 32.1** | Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | | | | |
| 101.INS | XBRL Instance Document | | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Linkbase Document | | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | | | | |

Constitutes a management contract or compensatory plan or arrangement.

** Document has been furnished, is deemed not filed and is

not to be incorporated by reference into any of TriNet Group, Inc.'s filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language contained in any such filing.