

# **BENEFITFOCUS, INC.**

## **FORM 10-Q** (Quarterly Report)

Filed 08/04/16 for the Period Ending 06/30/16

Address	100 BENEFITFOCUS WAY CHARLESTON, SC 29492
Telephone	843-849-7476
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Symbol	BNFT
SIC Code	7372 - Prepackaged Software
Industry	Software & Programming
Sector	Technology
Fiscal Year	12/31

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

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 30, 2016

or

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

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

Commission File Number: 001-36061

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**Benefitfocus, Inc.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

100 Benefitfocus Way  
Charleston, South Carolina 29492  
(Address of principal executive offices and zip code)

(843) 849-7476  
(Registrant's telephone number, including area code)

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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 July 29, 2016, there were approximately 29,652,487 shares of the registrant's common stock outstanding.

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**Benefitfocus, Inc.**

**Form 10-Q**

**For the Quarterly Period Ended June 30, 2016**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**Benefitfocus, Inc.**  
**Unaudited Consolidated Balance Sheets**  
*(in thousands, except share and per share data)*

	As of June 30, 2016	As of December 31, 2015
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 56,929	\$ 48,074
Marketable securities	11,069	40,448
Accounts receivable, net	28,440	27,616
Accounts receivable, related party	2,862	2,082
Prepaid expenses and other current assets	6,147	5,725
Total current assets	105,447	123,945
Property and equipment, net	55,763	55,037
Intangible assets, net	536	665
Goodwill	1,634	1,634
Other non-current assets	1,377	838
Total assets	<u>\$ 164,757</u>	<u>\$ 182,119</u>
<b>Liabilities and stockholders' deficit</b>		
Current liabilities:		
Accounts payable	\$ 7,445	\$ 7,953
Accrued expenses	10,269	10,449
Accrued compensation and benefits	17,488	20,684
Deferred revenue, current portion	33,530	37,858
Revolving line of credit, current portion	34,000	25,000
Financing and capital lease obligations, current portion	2,885	3,648
Total current liabilities	105,617	105,592
Deferred revenue, net of current portion	50,067	55,671
Revolving line of credit, net of current portion	5,246	5,246
Financing and capital lease obligations, net of current portion	33,095	31,183
Other non-current liabilities	2,523	2,436
Total liabilities	196,548	200,128
Commitments and contingencies		
Stockholders' deficit:		
Preferred stock, par value \$0.001, 5,000,000 shares authorized, no shares issued and outstanding at June 30, 2016 and December 31, 2015	—	—
Common stock, par value \$0.001, 50,000,000 shares authorized, 29,588,841 and 29,194,332 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	30	29
Additional paid-in capital	320,877	310,304
Accumulated deficit	(352,698)	(328,342)
Total stockholders' deficit	(31,791)	(18,009)
Total liabilities and stockholders' deficit	<u>\$ 164,757</u>	<u>\$ 182,119</u>

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

**Benefitfocus, Inc.**  
**Unaudited Consolidated Statements of Operations and Comprehensive Loss**  
*(in thousands, except share and per share data)*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 57,874	\$ 42,708	\$ 112,666	\$ 85,377
Cost of revenue	29,750	23,640	59,047	46,103
Gross profit	28,124	19,068	53,619	39,274
Operating expenses:				
Sales and marketing	14,761	15,804	28,335	31,279
Research and development	14,180	13,271	29,195	25,048
General and administrative	8,274	6,393	16,669	11,804
Total operating expenses	37,215	35,468	74,199	68,131
Loss from operations	(9,091)	(16,400)	(20,580)	(28,857)
Other income (expense):				
Interest income	36	56	92	74
Interest expense on building lease financing obligations	(1,710)	(1,730)	(3,426)	(3,644)
Interest expense on other borrowings	(231)	(210)	(429)	(490)
Other (expense) income	(3)	5	(3)	4
Total other expense, net	(1,908)	(1,879)	(3,766)	(4,056)
Loss before income taxes	(10,999)	(18,279)	(24,346)	(32,913)
Income tax expense	5	5	10	20
Net loss	\$ (11,004)	\$ (18,284)	\$ (24,356)	\$ (32,933)
Comprehensive loss	\$ (11,004)	\$ (18,284)	\$ (24,356)	\$ (32,933)
Net loss per common share:				
Basic and diluted	\$ (0.37)	\$ (0.64)	\$ (0.83)	\$ (1.19)
Weighted-average common shares outstanding:				
Basic and diluted	29,459,341	28,633,992	29,336,270	27,694,935

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

**Benefitfocus, Inc.**  
**Unaudited Consolidated Statement of Changes in Stockholders' Deficit**  
*(in thousands, except share and per share data)*

	Common Stock, \$0.001 Par Value		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Par Value			
Balance, December 31, 2015	29,194,332	\$ 29	\$ 310,304	\$ (328,342)	\$ (18,009)
Exercise of stock options	214,219	1	1,592	—	1,593
Issuance of common stock upon vesting of restricted stock units, net of shares surrendered for taxes	180,290	—	(202)	—	(202)
Stock-based compensation expense	—	—	9,183	—	9,183
Net loss	—	—	—	(24,356)	(24,356)
Balance, June 30, 2016	<u>29,588,841</u>	<u>\$ 30</u>	<u>\$ 320,877</u>	<u>\$ (352,698)</u>	<u>\$ (31,791)</u>

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

**Benefitfocus, Inc.**  
**Unaudited Consolidated Statements of Cash Flows**  
*(in thousands)*

	Six Months Ended June 30,	
	2016	2015
<b>Cash flows from operating activities</b>		
Net loss	\$ (24,356)	\$ (32,933)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	6,310	5,726
Stock-based compensation expense	9,183	4,617
Interest accrual on financing obligation	3,426	3,644
Loss on disposal or impairment of property and equipment	7	8
Provision for doubtful accounts	(22)	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,582)	(614)
Accrued interest on short-term investments	158	88
Prepaid expenses and other current assets	(72)	(1,523)
Other non-current assets	291	711
Accounts payable	(1,279)	1,427
Accrued expenses	741	648
Accrued compensation and benefits	(3,196)	1,868
Deferred revenue	(9,932)	(495)
Other non-current liabilities	87	189
Net cash and cash equivalents used in operating activities	<u>(20,236)</u>	<u>(16,639)</u>
<b>Cash flows from investing activities</b>		
Purchases of short-term investments held to maturity	(2,004)	(51,111)
Proceeds from maturity of short-term investments held to maturity	31,225	8,067
Purchases of property and equipment	(4,964)	(8,054)
Net cash and cash equivalents provided by (used in) investing activities	<u>24,257</u>	<u>(51,098)</u>
<b>Cash flows from financing activities</b>		
Draws on revolving line of credit	34,000	22,492
Payments on revolving line of credit	(25,000)	(34,903)
Proceeds from exercises of stock options	1,593	1,318
Proceeds from issuance of common stock and warrant, net of issuance costs	—	74,538
Payment of deferred financing costs and debt issuance costs	—	(566)
Remittance of taxes upon vesting of restricted stock units	(202)	(874)
Payments on financing and capital lease obligations	(5,557)	(4,918)
Net cash and cash equivalents provided by financing activities	<u>4,834</u>	<u>57,087</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	8,855	(10,650)
Cash and cash equivalents, beginning of period	48,074	51,074
<b>Cash and cash equivalents, end of period</b>	<u>\$ 56,929</u>	<u>\$ 40,424</u>
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Property and equipment purchases in accounts payable and accrued expenses	<u>\$ 1,397</u>	<u>\$ 1,558</u>
Property and equipment purchased with financing and capital lease obligations	<u>\$ 2,099</u>	<u>\$ 236</u>
Post contract support purchased with financing obligations	<u>\$ 1,182</u>	<u>\$ —</u>
Allocation of proceeds to deferred revenue from issuance of common stock based on relative selling price	<u>\$ —</u>	<u>\$ 207</u>

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

**BENEFITFOCUS, INC.**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share and per share data)

**1. Organization and Description of Business**

Benefitfocus, Inc. (the "Company") provides a leading cloud-based benefits management platform for consumers, employers, insurance carriers and brokers under a software-as-a-service ("SaaS") model. The financial statements of the Company include the financial position and operations of its wholly owned subsidiaries, Benefitfocus.com, Inc., Benefit Informatics, Inc. and BenefitStore, Inc. Benefit Informatics, Inc. was dissolved on December 31, 2015.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation***

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. We are not the primary beneficiary of, nor do we have a controlling financial interest in, any variable interest entity. Accordingly, we have not consolidated any variable interest entity.

***Interim Unaudited Consolidated Financial Information***

The accompanying unaudited consolidated financial statements and footnotes have been prepared in accordance with GAAP as contained in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification (the "Codification" or "ASC") for interim financial information, and with Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the results of operations, financial position, changes in stockholders' equity and cash flows. The results of operations for the three- and six-month periods ended June 30, 2016 are not necessarily indicative of the results for the full year or for any other future period. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related footnotes for the year ended December 31, 2015 included in the Company's Annual Report on Form 10-K filed with the United States Securities and Exchange Commission on February 25, 2016.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Such estimates include revenue recognition and the customer relationship period, allowances for doubtful accounts and returns, valuations of deferred income taxes, long-lived assets, warrants, capitalizable software development costs and the related amortization, stock-based compensation, the determination of the useful lives of assets and the recognition and impairment assessment of acquired intangibles and goodwill. Determination of these transactions and account balances are based on the Company's estimates and judgments. These estimates are based on the Company's knowledge of current events and actions it may undertake in the future as well as on various other assumptions that it believes to be reasonable. Actual results could differ materially from these estimates.

***Revenue and Deferred Revenue***

The Company derives the majority of its revenue from software services, which consist primarily of monthly subscription fees paid by customers for access to and usage of the Company's cloud-based benefits software solutions for a specified contract term. The Company also derives revenue from professional services, which primarily includes fees related to the integration of customers' systems with the Company's platform, typically including discovery, configuration, deployment, testing, and training.

The Company recognizes revenue when there is persuasive evidence of an arrangement, the service has been provided, the fees to be paid by the customer are fixed and determinable and collectability is reasonably assured. The Company considers delivery of its cloud-based software services has commenced once it has granted the customer access to its platform.

The Company's arrangements generally contain multiple elements comprised of software services and professional services. The Company evaluates each element in an arrangement to determine whether it represents a

separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control.

When multiple deliverables included in an arrangement are separable into different units of accounting, the arrangement consideration is allocated to the identified units of accounting based on their relative selling price. Multiple deliverable arrangements accounting guidance provides a hierarchy to use when determining the relative selling price for each unit of accounting. Vendor-specific objective evidence ("VSOE") of selling price, based on the price at which the item is regularly sold by the vendor on a standalone basis, should be used if it exists. If VSOE is not available, third-party evidence ("TPE") is used to establish the selling price if it exists. VSOE and TPE do not currently exist for any of the Company's deliverables. Accordingly, for arrangements with multiple deliverables that can be separated into different units of accounting, the arrangement consideration is allocated to the separate units of accounting based on the Company's best estimate of selling price. The amount of arrangement consideration allocated is limited by contingent revenues, if any.

Effective July 1, 2015, the Company determined it had established standalone value for Benefitfocus Marketplace implementation services in the Employer segment because beginning then they could be sold separately from the software services. This was primarily due to the system integrators that have been trained and certified to perform these implementation services, the successful completion of an implementation by a trained system integrator, and the sale of several software subscription arrangements to customers in the Employer segment without the Company's implementation services. Accordingly, revenues related to implementation services for the Benefitfocus Marketplace solution in the Employer segment delivered after July 1, 2015 are recognized separately from the revenues earned from the Employer software subscription services. Revenues related to such implementation services are recognized at the time that the professional services have been completed and the related software services have commenced. Prior to July 1, 2015, the Company did not have standalone value for implementation services related to the Benefitfocus Marketplace solution as the Company had historically performed these services to support the customers' implementation of this solution. Revenue from implementation services with standalone value was \$368 and \$642 for the three and six month periods ended June 30, 2016, respectively.

Certain of the Company's other professional services, including implementation services related to the Carrier segment, are not sold separately from the software services and there is no alternative use for them. As such, the Company has determined that those professional services do not have standalone value. Accordingly, software services and professional services are combined and recognized as a single unit of accounting. The Company generally recognizes software services fees monthly based on the number of employees covered by the relevant benefits plans at contracted rates for a specified period of time, once the criteria for revenue recognition described above have been satisfied. The Company defers recognition of revenue for fees from professional services that do not have standalone value and begins recognizing such revenue once the services are delivered and the related software services have commenced, ratably over the longer of the contract term or the estimated expected life of the customer relationship. Costs incurred by the Company in connection with providing such professional services are charged to expense as incurred and are included in "Cost of revenue."

#### **Concentrations of Credit Risk**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash equivalents, marketable securities and accounts receivable. All of the Company's cash and cash equivalents are held at financial institutions that management believes to be of high credit quality. The bank deposits of the Company might, at times, exceed federally insured limits and are generally uninsured and uncollateralized. The Company has not experienced any losses on cash and cash equivalents to date.

To manage credit risk related to marketable securities, the Company invests in various types of highly rated corporate bonds, commercial paper, and various United States backed securities with maturities of less than two years. The weighted average maturity of the portfolio of investments must not exceed nine months, per the Company's investment policy.

To manage accounts receivable risk, the Company evaluates the creditworthiness of its customers and maintains an allowance for doubtful accounts. Accounts receivable are unsecured and derived from revenue earned from customers located in the United States. One customer, North Carolina State Health Plan, represented 22.2% of the total accounts receivable at December 31, 2015 and represented 10.4% of the total revenue for the three-month period ended June 30, 2016. Another customer, Aetna, represented 10.0% of total revenue for the three- and six-month periods ended June 30, 2015. Mercer, a related party, represented 11.6% and 10.9% of total revenue for the three- and six-month periods ended June 30, 2016, respectively. For more information regarding Mercer revenue, please see Note 11.

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

Accounts receivable are stated at realizable value, net of allowances for doubtful accounts and returns. The Company utilizes the allowance method to provide for doubtful accounts based on management's evaluation of the collectability of amounts due, and other relevant factors. Bad debt expense is recorded in general and administrative expense on the consolidated statements of operations and comprehensive loss. The Company's estimate is based on historical collection experience and a review of the current status of accounts receivable. Historically, actual write-offs for uncollectible accounts have not significantly differed from the Company's estimates. The Company removes recorded receivables and the associated allowances when they are deemed permanently uncollectible. However, if bad debts are higher than expected future write-offs will be greater than the Company's estimates. The allowance for doubtful accounts was \$10 and \$32 as of June 30, 2016 and December 31, 2015, respectively.

The allowances for returns are accounted for as reductions of revenue and are estimated based on the Company's periodic assessment of historical experience and trends. The Company considers factors such as the time lag since the initiation of revenue recognition, historical reasons for adjustments, new customer volume, complexity of billing arrangements, timing of software availability, and past due customer billings. The allowance for returns was \$2,782 and \$2,553 as of June 30, 2016 and December 31, 2015, respectively.

### ***Capitalized Software Development Costs***

The Company capitalizes certain costs related to its software developed or obtained for internal use. Costs related to preliminary project activities and post-implementation activities are expensed as incurred. Internal and external costs incurred during the application development stage, including upgrades and enhancements representing modifications that will result in significant additional functionality, are capitalized. Software maintenance and training costs are expensed as incurred. Capitalized costs are recorded as part of property and equipment and are amortized on a straight-line basis to cost of revenue over the software's estimated useful life, which is three years. The Company evaluates these assets for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

In the three months ended June 30, 2016 and 2015, the Company capitalized software development costs of \$1,501 and \$506, respectively, and amortized capitalized software development costs of \$693 and \$671, respectively. In the six months ended June 30, 2016 and 2015, respectively, the Company capitalized software development costs of \$2,985 and \$1,051, and amortized capitalized software development costs of \$1,319 and \$1,347, respectively. The net book value of capitalized software development costs was \$5,715 and \$4,049 at June 30, 2016 and December 31, 2015, respectively.

### ***Comprehensive Loss***

The Company's net loss equals comprehensive loss for all periods presented.

### ***Accounting Standards Not Yet Adopted***

In June 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-13: Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The purpose of this ASU is to require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This ASU is effective for interim and annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09: Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting. The amendments in this update simplify several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for the Company beginning January 1, 2017, but early adoption is permitted. The Company is currently evaluating the impact of this update on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02: Leases (Topic 842). The amendments in this update require lessees, among other things, to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous authoritative guidance. This update also introduces new disclosure requirements for leasing arrangements. ASU 2016-02 will be effective for the Company beginning January 1, 2019, but early adoption is permitted. The Company is currently evaluating the impact of this update on the consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05: Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 35 0-40) - Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. The amendments in this update provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. The Company adopted ASU 2015-05 as of January 1, 2016 on a prospective basis. The adoption of this standard did not materially impact the Company's consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03: Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company adopted this standard as of January 1, 2016. The adoption of this standard did not materially impact the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40). ASU 2015-11 provides guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance is effective for the Company beginning January 1, 2017. The Company does not believe the adoption of this standard will have a material effect on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09: Revenue from Contracts with Customers (Topic 606), which amends the revenue recognition requirements in the FASB Accounting Standards Codification, and various clarifying updates. This statement requires 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 statement shall be applied using one of two methods: retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying this statement recognized at the date of initial application. The Company has not yet determined which method it will apply. This guidance will be effective for the Company beginning January 1, 2018, with an option to early adopt. The Company is currently evaluating the impact of this guidance on its consolidated financial position and results of operations.

### 3. Net Loss Per Common Share

Diluted loss per common share is the same as basic loss per common share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company's net loss. The following common share equivalent securities have been excluded from the calculation of weighted average common shares outstanding because the effect is anti-dilutive for the periods presented:

Anti-Dilutive Common Share Equivalents	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Restricted stock units	1,474,403	998,889	1,474,403	998,889
Stock options	1,458,140	2,134,685	1,458,140	2,134,685
Warrant to purchase common stock	580,813	580,813	580,813	580,813
Total anti-dilutive common share equivalents	<u>3,513,356</u>	<u>3,714,387</u>	<u>3,513,356</u>	<u>3,714,387</u>

Basic and diluted net loss per common share is calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net loss	\$ (11,004)	\$ (18,284)	\$ (24,356)	\$ (32,933)
Net loss attributable to common stockholders	<u>\$ (11,004)</u>	<u>\$ (18,284)</u>	<u>\$ (24,356)</u>	<u>\$ (32,933)</u>
Denominator:				
Weighted-average common shares outstanding, basic and diluted	29,459,341	28,633,992	29,336,270	27,694,935
Net loss per common share, basic and diluted	<u>\$ (0.37)</u>	<u>\$ (0.64)</u>	<u>\$ (0.83)</u>	<u>\$ (1.19)</u>

#### 4. Fair Value Measurement

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, net accounts receivable, accounts payable and other accrued liabilities, and accrued compensation and benefits, approximate fair value due to their short-term nature. The carrying value of the Company's financing obligations and revolving line of credit approximates fair value, considering the borrowing rates currently available to the Company with similar terms and credit risks.

The Company uses a three-tier fair value hierarchy to classify and disclose all assets and liabilities measured at fair value on a recurring basis, as well as assets and liabilities measured at fair value on a non-recurring basis, in periods subsequent to their initial measurement. The hierarchy requires the Company to use observable inputs when available, and to minimize the use of unobservable inputs when determining fair value. The three tiers are defined as follows:

- Level 1.** Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2.** Other inputs that are directly or indirectly observable in the marketplace.
- Level 3.** Unobservable inputs for which there is little or no market data, which require the Company to develop its own assumptions.

#### Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company evaluates its financial assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. This determination requires significant judgments to be made.

The following tables present information about the Company's assets and liabilities that are measured at fair value on a recurring basis using the above categories, as of June 30, 2016 and December 31, 2015.

Description	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Cash Equivalents:				
Money market mutual funds (1)	\$ 53,626	\$ —	\$ —	\$ 53,626
Total assets	<u>\$ 53,626</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 53,626</u>
December 31, 2015				
Description	Level 1	Level 2	Level 3	Total
Cash Equivalents:				
Money market mutual funds (1)	\$ 46,905	\$ —	\$ —	\$ 46,905
Total assets	<u>\$ 46,905</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 46,905</u>

(1) Money market funds are classified as cash equivalents in the Company's unaudited consolidated balance sheets. As short-term, highly liquid investments readily convertible to known amounts of cash with remaining maturities of three months or less at the time of purchase, the Company's cash equivalent money market funds have carrying values that approximate fair value.

## 5. Marketable Securities

Marketable securities consist of corporate bonds, commercial paper, U.S. Treasury and agency bonds and are classified as held-to-maturity. Investments held in marketable securities had contractual maturities of between 1 and 7 months as of June 30, 2016. The following presents information about the Company's marketable securities as of:

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Aggregate cost basis and net carrying amount	\$ 11,069	\$ 40,448
Gross unrealized holding gains	6	1
Gross unrealized holding losses	-	(26)
Aggregate fair value determined by Level 2 inputs	<u>\$ 11,075</u>	<u>\$ 40,423</u>

The following table presents information about the Company's investments that were in an unrealized loss position and for which an other-than-temporary impairment has not been recognized in earnings as of:

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Aggregate fair value of investments with unrealized losses (1)	\$ 2,025	\$ 27,070
Aggregate amount of unrealized losses	-	(26)

(1) Investments have been in a continuous loss position for less than 12 months.

## 6. Revolving Line of Credit

As of June 30, 2016 and December 31, 2015, the amount outstanding under the Company's revolving line of credit was \$39,246 and \$30,246, respectively. The amount available to borrow, adjusted by the borrowing base limit, was \$20,754 and the interest rate was 4.5% as of June 30, 2016.

In January 2016, the Company repaid \$25,000 of the amount outstanding under this line of credit. In June 2016, the Company borrowed \$34,000 for general operating purposes.

## 7. Stock-based Compensation

### Restricted Stock Units

During January 2016, the Company granted 31,233 restricted stock units to employees with an aggregate grant date fair value of \$1,091. During April 2016, the Company granted 425,183 restricted stock units to employees with an aggregate grant date fair value of \$13,776. These restricted stock units vest in equal annual installments generally over 4 years from the grant date. The Company amortizes the fair value of the stock subject to the restricted stock units at the time of grant on a straight-line basis over the period of vesting. The Company recognizes the income tax benefits resulting from vesting of restricted stock units in the period they vest, to the extent the compensation expense has been recognized.

During the six months ended June 30, 2016, the Company granted 242,331 performance restricted stock units to management with an aggregate grant date fair value of \$7,490. Vesting is contingent upon meeting various financial targets to support growth initiatives through December 31, 2017. The actual number of shares issued upon vesting could range from 0% to 100% of the number granted.

During March 2016, the Company granted 26,376 performance restricted stock units to management with an aggregate grant date fair value of \$875. The awards were granted in lieu of a portion of the target cash bonus that would otherwise be payable under the Company's Management Incentive Bonus Program for the calendar year

ended 2016. The awards vest upon achievement of annual financial targets for 2016. The actual number of shares issued upon vesting could range from 0% to 100% of the number granted.

## 8. Stockholders' Deficit

### Common Stock

The holders of common stock are entitled to one vote for each share. The voting, dividend and liquidation rights of the holders of common stock are subject to and qualified by the rights, powers and preferences of the holders of preferred stock.

At the Company's annual stockholder meeting held in June 2016, the Company's stockholders approved the Benefitfocus, Inc. 2016 Employee Stock Purchase Plan ("ESPP") pursuant to which 150,000 shares of the Company's common stock is available for purchase by its employees (and employees of its subsidiaries) who meet certain criteria. The Company's board of directors approved the ESPP in March 2016. Under the ESPP, eligible employees may purchase the Company's common stock through accumulated payroll deductions. Options to purchase shares are granted twice yearly on or about January 1 and July 1 and exercisable on or about the succeeding June 30 and December 31, respectively, of each year. Shares are purchased at purchase prices equal to 95% of the fair market value of the Company's common stock at the purchase date. No participant may purchase more than \$12,500 worth of the Company's common stock in a six-month offering period. The ESPP's initial purchase period began in July 2016. Accordingly, no shares of the Company common stock had been purchased or distributed pursuant to the ESPP as of June 30, 2016.

At June 30, 2016, the Company had reserved a total of 4,574,415 of its authorized 50,000,000 shares of common stock for future issuance as follows:

Outstanding stock options	1,458,140
Restricted stock units	1,474,403
Available for future issuance under stock option plans	911,059
Available for future issuance under employee stock purchase plan	150,000
Warrant to purchase common stock	580,813
Total common shares reserved for future issuance	<u>4,574,415</u>

## 9. Income Taxes

The Company's effective federal tax rate for the three and six months ended June 30, 2016 was less than one percent, primarily as a result of estimated tax losses for the fiscal year offset by the increase in the valuation allowance in the net operating loss carryforwards. Current tax expense relates to estimated state income taxes.

## 10. Segments and Geographic Information

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker ("CODM") for purposes of allocating resources and evaluating financial performance. The Company's CODM, the Chief Executive Officer, reviews financial information presented on a consolidated basis, accompanied by information about operating segments, for purposes of allocating resources and evaluating financial performance.

The Company's reportable segments are based on the type of customer. The Company determined its operating segments to be: Employer, which derives substantially all of its revenue from customers that use the Company's services for the provision of benefits to their employees, and administrators acting on behalf of employers; and Carrier, which derives substantially all of its revenue from insurance companies that provide coverage at their own risk.

Segments are evaluated based on gross profit. The Company does not allocate interest income, interest expense or income tax expense by segment. Accordingly, the Company does not report such information. Additionally, Employer and Carrier segments share the majority of the Company's assets. Therefore, no segment asset information is reported.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue from external customers by segment:				
Employer	\$ 36,261	\$ 20,779	\$ 68,454	\$ 41,677
Carrier	21,613	21,929	44,212	43,700
Total net revenue from external customers	<u>\$ 57,874</u>	<u>\$ 42,708</u>	<u>\$ 112,666</u>	<u>\$ 85,377</u>
Depreciation and amortization by segment:				
Employer	\$ 1,975	\$ 1,450	\$ 3,767	\$ 2,792
Carrier	1,292	1,453	2,543	2,934
Total depreciation and amortization	<u>\$ 3,267</u>	<u>\$ 2,903</u>	<u>\$ 6,310</u>	<u>\$ 5,726</u>
Gross profit by segment:				
Employer	\$ 15,269	\$ 7,571	\$ 27,551	\$ 16,125
Carrier	12,855	11,497	26,068	23,149
Total gross profit	<u>\$ 28,124</u>	<u>\$ 19,068</u>	<u>\$ 53,619</u>	<u>\$ 39,274</u>

## 11. Related Parties

### **Related Party Leasing Arrangements**

The Company leases the buildings and office space on its Charleston, South Carolina campus from entities with which two of the Company's directors, significant stockholders, and executives are affiliated. The leasing arrangements have 15-year terms which started in 2006, 2009 and 2015. The Company has an option to renew the 2006 and 2009 arrangements for one five-year period and an option to renew the 2015 arrangement for up to five one-year periods. The arrangements provide for 3.0% fixed annual rent increases. Payments under these agreements were \$2,286 and \$2,220 for the three months ended June 30, 2016 and 2015, respectively and \$5,666 and \$7,172 for the six months ended June 30, 2016 and 2015, respectively. Amounts due to the related parties were \$1,262 and \$1,116 as of June 30, 2016 and December 31, 2015, respectively. As of June 30, 2016 and December 31, 2015 amounts due to the related parties were recorded in "Accrued expenses."

### **Other Related Party Expenses**

The Company utilizes the services of three companies that are owned and controlled by a Company director, significant stockholder, and executive. The companies provide private air transportation and construction project management services. Expenses related to these companies were \$11 and \$28 for the three months ended June 30, 2016 and 2015 and \$37 and \$82 for the six months ended June 30, 2016 and 2015, respectively. No amounts were due to these companies as of June 30, 2016 and December 31, 2015.

### **Related Party Revenues**

Mercer became a related party when the Company sold it over 10% beneficial ownership of the Company's outstanding common stock in February 2015. Revenue from Mercer was \$6,712 and \$3,501 for the three months ended June 30, 2016 and 2015, respectively and \$12,258 and \$4,615 for the six months ended June 30, 2016 and 2015, respectively, from the time they became a related party and was reflected in "Revenues," within the accompanying statements of operations. The amounts due from Mercer were \$2,862 and \$2,082 as of June 30, 2016 and December 31, 2015, respectively. The amount of deferred revenue associated with Mercer was \$7,863 and \$9,128 as of June 30, 2016 and December 31, 2015, respectively, and was reflected in the balances of deferred revenue in the consolidated balance sheets.

## **1 2. Subsequent Events**

### ***Restricted Stock Units***

During July 2016, the Company granted 31,391 restricted stock units to employees with an aggregate grant date fair value of \$1,181. Generally, these restricted stock units vest in equal annual installments over 4 years from the grant date. The Company amortizes the fair value of the stock subject to the restricted stock units at the time of grant on a straight-line basis over the period of vesting. The Company recognizes the income tax benefits resulting from vesting of restricted stock units in the period they vest, to the extent the compensation expense has been recognized.

### ***Common Stock***

During July 2016, employees exercised stock options and restricted stock units vested resulting in the issuance of 63,646 shares.

### ***Revolving Line of Credit***

In July 2016, the Company repaid \$34,000 under its revolving line of credit.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and with the financial statements, related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" included in Item 1A of Part II of this Quarterly Report on Form 10-Q, and the risks discussed in our other SEC filings.*

### Overview

Benefitfocus provides a leading cloud-based benefits management platform for consumers, employers, insurance carriers, and brokers. The Benefitfocus Platform simplifies how organizations and individuals shop for, enroll in, manage, and exchange benefits. Our employer and insurance carrier customers rely on our platform to manage, scale and exchange benefits. Our web-based platform has a user-friendly interface designed to enable the insured consumers to access all of their benefits in one place. Our comprehensive solutions support core benefits plans, including healthcare, dental, life, and disability insurance, and voluntary benefits plans, such as critical illness, supplemental income, and wellness programs. As the number of employer benefits plans has increased, with each plan subject to many different business rules and requirements, demand for the Benefitfocus Platform has grown.

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

We sell the Benefitfocus Platform on a subscription basis, typically through annual contracts with employer customers and multi-year contracts with our insurance carrier customers, with subscription fees paid monthly. The multi-year contracts with our carrier customers are generally only cancellable by the carrier in an instance of our uncured breach, although some of our carrier customers are able to terminate their respective contracts without cause or for convenience. Software services revenue accounted for approximately 88% and 89% of our total revenue during the three months ended June 30, 2016 and 2015, respectively and 89% and 89% of our total revenue during the six months ended June 30, 2016 and 2015, respectively.

Another component of our revenue is professional services. We derive the majority of our professional services revenue from the implementation of our customers onto our platform, which typically includes discovery, configuration and deployment, integration, testing, and training. In general, it takes from four to five months to implement a new employer customer's benefits systems and eight to 10 months to implement a new carrier customer's benefits systems. We also provide customer support services and customized media content that supports our customers' effort to educate and communicate with consumers. Professional services revenue accounted for approximately 12% and 11% of our total revenue during the three months ended June 30, 2016 and 2015, respectively and 11% and 11% of our total revenue during the six months ended June 30, 2016 and 2015, respectively.

Increasing our base of large employer customers is an important source of revenue growth for us. We actively pursue new employer customers in the U.S. market, and we have increased the number of large employer customers utilizing our solutions from 141 as of December 31, 2010 to 803 as of June 30, 2016. We believe that our continued innovation and new solutions, such as online benefits marketplaces, also known as private exchanges, enhanced mobile offerings, and more robust data analytics capabilities will help us attract additional large employer customers and increase our revenue from existing customers.

We believe that there is a substantial market for our services, and we have been investing in growth over the past five years. In particular, we have continued to invest in technology and services to better serve our larger employer customers, which we believe are an important source of growth for our business. We have also

substantially increased our marketing and sales efforts and expect those increased efforts to continue. As we have invested in growth, we have had operating losses in each of the last six years, and expect our operating losses to continue for at least the next year. Due to the nature of our customer relationships, which have been very stable with relatively few customer losses over the past years, and the subscription nature of our financial model, we believe that our current investment in growth should lead to substantially increased revenue, which will allow us to achieve profitability in the relatively near future. Of course, our ability to achieve profitability will continue to be subject to many factors beyond our control.

### Key Financial and Operating Performance Metrics

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

#### Number of Large Employer and Carrier Customers

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

	As of June 30,	
	2016	2015
Number of customers:		
Large employer	803	662
Carrier	53	52

#### Software Services Revenue Retention Rate

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

For the three- and six-month periods ending June 30, 2016 and 2015, our software services revenue retention rate exceeded 95%.

#### Adjusted EBITDA

Adjusted EBITDA represents our earnings before net interest, taxes, and depreciation and amortization expense, adjusted to eliminate stock-based compensation and impairment of goodwill and intangible assets. We believe that the exclusion of the expenses eliminated in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results. However, adjusted EBITDA is not a measure calculated in accordance with United States generally accepted accounting principles, or GAAP, and should not be considered as alternatives to any measures of financial performance calculated and presented in accordance with GAAP.

Our use of adjusted EBITDA as an analytical tool has limitations, and you should not consider it in isolation or as a substitute for analysis of our financial results as reported under GAAP. Some of these limitations are:

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized might have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not reflect the potentially dilutive impact of stock-based compensation;

- adjusted EBITDA does not reflect interest or tax payments that would reduce the cash available to us; and
- other companies, including companies in our industry, might calculate adjusted EBITDA or a similarly titled measure differently, which reduces their usefulness as comparative measures.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Reconciliation from Net Loss to Adjusted EBITDA:</b>				
Net loss	\$ (11,004)	\$ (18,284)	\$ (24,356)	\$ (32,933)
Depreciation	2,509	2,156	4,862	4,226
Amortization of software development costs	693	671	1,319	1,347
Amortization of acquired intangible assets	65	76	129	153
Interest income	(36)	(56)	(92)	(74)
Interest expense on building lease financing obligations	1,710	1,730	3,426	3,644
Interest expense on other borrowings	231	210	429	490
Income tax expense	5	5	10	20
Stock-based compensation expense	4,450	2,781	9,183	4,617
Total net adjustments	9,627	7,573	19,266	14,423
Adjusted EBITDA	\$ (1,377)	\$ (10,711)	\$ (5,090)	\$ (18,510)

## Components of Operating Results

### Revenue

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Software services	\$ 51,021	\$ 38,128	\$ 100,013	\$ 75,881
Professional services	6,853	4,580	12,653	9,496
Total revenue	\$ 57,874	\$ 42,708	\$ 112,666	\$ 85,377

We generally recognize software services fees monthly based on the number of employees covered by the relevant benefits plans at contracted rates for a specified period of time, provided that an enforceable contract has been signed by both parties, access to our software has been granted to the customer and it is available for their use, the fee for the software services is fixed or determinable, and collection is reasonably assured. We defer recognition of our professional services fees paid by customers related to implementation services that are determined to not have stand-alone value and are sold with our software services, and recognize them, beginning once the software services have commenced, ratably over the longer of the contract term or the estimated expected life of the customer relationship, currently 7 years. We periodically evaluate the term over which revenue is recognized for professional services as we gain more experience with customer contract renewals.

As of July 1, 2015, we determined that we had established standalone value for the implementation services for the Benefitfocus Marketplace solution in the Employer segment because beginning then they could be sold separately from the software services. This was primarily due to the system integrators that have been trained and certified to perform these implementation services, the successful completion of an implementation by a trained system integrator, and the sale of several software subscription arrangements to customers in the Employer segment without the Company's implementation services. Accordingly, revenues related to implementation services for the Benefitfocus Marketplace solution in the Employer segment delivered after July 1, 2015 are recognized separately from the revenues earned from the Employer software subscription services. Revenues related to such implementation services are recognized at the time that the professional services have been completed. Prior to July 1, 2015, we did not have standalone value for implementation services related to the Benefitfocus Marketplace solution as we had historically performed these services to support our customers' implementation of this solution. The incremental revenue from recognition of services upon delivery compared to recognition over the customer relationship period of 7 years was \$0.3 million and \$0.6 million in the three and six month periods ended June 30, 2016.

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

#### **Overhead Allocation**

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

#### **Cost of Revenue**

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

We expense our cost of revenue as we incur the costs. However, the related revenue from fees we receive for our implementation services, performed before a customer is operating on our platform, that is determined to not have stand-alone value is deferred until the commencement of the monthly subscription and recognized as revenue ratably over the longer of the related contract term or the estimated expected life of the customer relationship. For those implementation services that have standalone value, the related revenue is recognized as revenue upon completion of service. Therefore, the cost incurred in providing these services is expensed in periods prior to the recognition of the corresponding revenue. Our cost associated with providing implementation services has been significantly higher as a percentage of revenue than our cost associated with providing our monthly subscription services due to the labor associated with implementation.

We plan to continue to expand our capacity to support our growth, which will result in higher cost of revenue in absolute dollars. However, we expect cost of revenue as a percentage of revenue to decline and gross margins to increase primarily from the growth of the percentage of our revenue from large employers and the realization of economies of scale driven by retention of our customer base.

#### **Operating Expenses**

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

**Sales and marketing expense.** Sales and marketing expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, stock-based compensation, and commissions for our sales and marketing associates. We record expense for commissions at the time of contract signing. Additional expenses include advertising, lead generation, promotional event programs, corporate communications, travel, and allocated overhead. For instance, our most significant promotional event is One Place, which we have held annually. We

expect our sales and marketing expense to increase in absolute dollars in the foreseeable future as we further increase the number of our sales and marketing professionals and expand our marketing activities in order to continue to grow our business.

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

**General and administrative expense.** General and administrative expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, and stock-based compensation for administrative, finance and accounting, legal, and human resource associates. Additional expenses include consulting and professional fees, insurance and other corporate expenses, and travel. We expect our general and administrative expenses to increase in absolute terms as we incur costs associated with compliance with the Sarbanes-Oxley Act and other professional services expenses.

### **Other Income and Expense**

Other income and expense consists primarily of interest income and expense and gain (loss) on disposal of fixed assets. Interest income represents interest received on our cash and cash equivalents and marketable securities. Interest expense consists primarily of the interest incurred on outstanding borrowings under our capital leases and financing obligations and credit facilities.

### **Income Tax Expense**

Income tax expense consists of U.S. federal and state income taxes. We incurred minimal income tax expense for the three and six month periods ended June 30, 2016 and 2015.

## **Results of Operations**

### **Consolidated Statements of Operations Data**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue	\$ 57,874	\$ 42,708	\$ 112,666	\$ 85,377
Cost of revenue (1)	29,750	23,640	59,047	46,103
Gross profit	28,124	19,068	53,619	39,274
Operating expenses:				
Sales and marketing (1)	14,761	15,804	28,335	31,279
Research and development (1)	14,180	13,271	29,195	25,048
General and administrative (1)	8,274	6,393	16,669	11,804
Total operating expenses	37,215	35,468	74,199	68,131
Loss from operations	(9,091)	(16,400)	(20,580)	(28,857)
Other income (expense):				
Interest income	36	56	92	74
Interest expense on building lease financing obligations	(1,710)	(1,730)	(3,426)	(3,644)
Interest expense on other borrowings	(231)	(210)	(429)	(490)
Other (expense) income:	(3)	5	(3)	4
Total other expense, net	(1,908)	(1,879)	(3,766)	(4,056)
Loss before income taxes	(10,999)	(18,279)	(24,346)	(32,913)
Income tax expense	5	5	10	20
Net loss	<u>\$ (11,004)</u>	<u>\$ (18,284)</u>	<u>\$ (24,356)</u>	<u>\$ (32,933)</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Cost of revenue	\$ 770	\$ 434	\$ 1,318	\$ 754
Sales and marketing	838	713	1,470	1,036
Research and development	1,059	613	2,527	1,052
General and administrative	1,783	1,021	3,868	1,775

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue	51.4	55.4	52.4	54.0
Gross profit	48.6	44.6	47.6	46.0
Operating expenses:				
Sales and marketing	25.5	37.0	25.1	36.6
Research and development	24.5	31.1	25.9	29.3
General and administrative	14.3	15.0	14.8	13.8
Total operating expenses	64.3	83.0	65.9	79.8
Loss from operations	(15.7)	(38.4)	(18.3)	(38.8)
Other income (expense):				
Interest income	0.1	0.1	0.1	0.1
Interest expense on building lease financing obligations	(3.0)	(4.1)	(3.0)	(4.3)
Interest expense on other borrowings	(0.4)	(0.5)	(0.4)	(0.6)
Other (expense) income:	-	-	-	-
Total other expense, net	(3.3)	(4.4)	(3.3)	(4.8)
Loss before income taxes	(19.0)	(42.8)	(21.6)	(38.6)
Income tax expense	-	-	-	-
Net loss	(19.0)%	(42.8)%	(21.6)%	(38.6)%

### Our Segments

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue from external customers by segment:				
Employer	\$ 36,261	\$ 20,779	\$ 68,454	\$ 41,677
Carrier	21,613	21,929	44,212	43,700
Total net revenue from external customers	\$ 57,874	\$ 42,708	\$ 112,666	\$ 85,377
Gross profit by segment:				
Employer	\$ 15,269	\$ 7,571	\$ 27,551	\$ 16,125
Carrier	12,855	11,497	26,068	23,149
Total gross profit	\$ 28,124	\$ 19,068	\$ 53,619	\$ 39,274

## Comparison of Three Months Ended June 30, 2016 and 2015

### Revenue

	Three Months Ended June 30,							
	2016				2015			
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	Period-to-Period Change		
	(in thousands)					Amount	Percentage	
Software services	\$ 51,021	88.2 %		\$ 38,128	89.3 %	\$ 12,893	33.8 %	
Professional services	6,853	11.8		4,580	10.7	2,273	49.6	
Total revenue	\$ 57,874	100.0 %		\$ 42,708	100.0 %	\$ 15,166	35.5 %	

Growth in software services revenue was primarily attributable volume increases with existing customers and the net addition of new customers, as the number of large employer and carrier customers increased to 856 as of June 30, 2016 from 714 as of June 30, 2015. Additionally, the launch of a new product offering, ACA Management & Reporting, which relates to reporting and compliance requirements under the Affordable Care Act, increased software services by \$4.4 million during the second quarter. This service is typically billed annually, in advance, and recognized as revenue when the services are provided.

The increase in professional services revenue was in part attributable to the recognition of \$1.0 million of implementation services, including \$0.7 million related to implementations of our new ACA Management & Reporting product as well as \$0.9 million related to professional services fees recognized over the customer relationship period.

### Segment Revenue

	Three Months Ended June 30,							
	2016				2015			
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	Period-to-Period Change		
	(in thousands)					Amount	Percentage	
Employer	\$ 36,261	62.7 %		\$ 20,779	48.7 %	\$ 15,482	74.5 %	
Carrier	21,613	37.3		21,929	51.3	(316)	(1.4)	
Total revenue	\$ 57,874	100.0 %		\$ 42,708	100.0 %	\$ 15,166	35.5 %	

Growth in employer revenue was primarily attributable to a \$14.3 million increase in our employer software services revenue driven by an increase of \$9.9 million associated with new customers and volume increases from existing customers. Additionally, the launch of our new product offering, ACA Management & Reporting, increased software services by \$4.4 million during the second quarter. This service is typically billed annually, in advance, and recognized as revenue when the services are provided. Employer professional services revenue increased \$1.0 million from implementation services, including \$0.7 million related to implementations of our ACA Management & Reporting product.

The decline in carrier revenue was attributable to a decrease of \$1.4 million in our carrier software services revenue, offset by an increase of \$1.0 million in our professional services revenue.

## Cost of Revenue

	Three Months Ended June 30,					
	2016			2015		
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	
	(in thousands)					
Cost of revenue	\$ 29,750	51.4 %	\$	23,640	55.4 %	\$ 6,110 25.8 %

The increase in cost of revenue in absolute terms was primarily attributable to a \$5.2 million increase in salaries and personnel-related costs for our customer success organization as we supported an increased number of large employer customers, and professional fees associated with the delivery of our recently launched product, ACA Management & Reporting. This increase included an increase in stock-based compensation of \$0.3 million. Additionally, we experienced \$0.8 million in increased depreciation and amortization and technology infrastructure costs to support the growth in headcount.

## Gross Profit

	Three Months Ended June 30,					
	2016			2015		
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	
	(in thousands)					
Software services	\$ 32,458	63.6 %	\$	24,432	64.1 %	\$ 8,026 32.9 %
Professional services	(4,334)	(63.2)		(5,364)	(117.1)	1,030 (19.2)
Gross profit	\$ 28,124	48.6 %	\$	19,068	44.6 %	\$ 9,056 47.5 %

The increase in software services gross profit in absolute terms was driven by a \$12.9 million, or 33.8%, increase in software services revenue. This increase was partially offset by a \$4.9 million, or 35.5%, increase in software services cost of revenue. Software services cost of revenue included \$0.4 million and \$0.2 million of stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively, and \$2.2 million and \$1.8 million of depreciation and amortization for the three months ended June 30, 2016 and 2015, respectively.

The increase in professional services gross loss was driven by a \$2.3 million, or 49.6% increase in professional services revenue, offset by a \$1.2 million, or 12.5%, increase in professional services cost of revenue. Professional services cost of revenue included \$0.3 million and \$0.2 million of stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively. In addition, professional services cost of revenue included \$0.3 million in depreciation and amortization for each of the three months ended June 30, 2016 and 2015. As discussed in "Components of Operating Results—Cost of Revenue", our cost of revenue is expensed as we incur the costs.

## Segment Gross Profit

	Three Months Ended June 30,					
	2016			2015		
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	
	(in thousands)					
Employer	\$ 15,269	42.1 %	\$	7,571	36.4 %	\$ 7,698 101.7 %
Carrier	12,855	59.5		11,497	52.4	1,358 11.8
Gross profit	\$ 28,124	48.6 %	\$	19,068	44.6 %	\$ 9,056 47.5 %

Employer gross profit increased by \$7.7 million, or 101.7%, between the three months ended June 30, 2016 and 2015. The \$15.5 million, or 74.5%, increase in employer revenue was partially offset by a \$7.8 million, or 58.9%, increase in employer cost of revenue. The increase in cost of revenue is primarily attributable an increase in associate headcount in our customer success organization which provides support and implementation services to our expanding customer base and professional fees associated with the delivery of our recently launched product,

ACA Management & Reporting. Our employer gross profit included \$0.5 million and \$0.2 million of stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively. In addition, our employer gross profit included \$1.5 million and \$1.1 million of depreciation and amortization for the three months ended June 30, 2016 and 2015, respectively.

Carrier gross profit increased by \$1.4 million, or 11.8%, between the three months ended June 30, 2016 and 2015 as carrier revenue slightly decreased \$0.3 million, or 1.4%, and carrier cost of revenue decreased by \$1.7 million, or 16.0%. Our carrier gross profit included \$0.3 million and \$0.2 million of stock-based compensation expense for the three months ended June 30, 2016 and 2015, respectively. In addition, our carrier gross profit included \$1.0 million and \$1.1 million in depreciation and amortization for the three months ended June 30, 2016 and 2015, respectively.

### Operating Expenses

	Three Months Ended June 30,						Period-to-Period Change	
	2016		2015		Amount	Percentage	Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue				
	(in thousands)							
Sales and marketing	\$ 14,761	25.5 %	\$ 15,804	37.0 %	\$ (1,043)	(6.6) %		
Research and development	\$ 14,180	24.5 %	\$ 13,271	31.1 %	\$ 909	6.8 %		
General and administrative	\$ 8,274	14.3 %	\$ 6,393	15.0 %	\$ 1,881	29.4 %		

The decrease in sales and marketing expense was attributable to savings from efficiencies, including a \$0.6 million decrease in travel-related expenses and \$0.5 million decrease in professional fees and other operating expenses. These savings were partially offset by a \$0.2 million increase in salaries and personnel-related costs. Included in this increase is an increase in stock-based compensation of \$0.1 million attributable to equity awards granted to new and existing sales and marketing associates.

The increase in research and development expense in absolute terms was partly attributable to a \$0.6 million increase in salaries and personnel-related costs. Included in this increase is an increase in stock-based compensation of \$0.4 million attributable to equity awards granted to new and existing research and development associates. Additionally, we experienced a \$0.3 million increase in technology infrastructure costs.

The increase in general and administrative expense was primarily attributable to a \$1.7 million increase in salaries and personnel-related costs due to additional general and administrative headcount, including an increase in stock-based compensation of \$0.8 million attributable to equity awards granted to new and existing general and administrative associates. We also experienced a \$0.4 million increase in facilities costs, depreciation expense and technology infrastructure costs. These increases were partially offset by the fact that in the quarter ended June 30, 2015, we incurred \$0.2 million in professional fees primarily related to our secondary offering of shares in August 2015.

### Comparison of Six Months Ended June 30, 2016 and 2015

#### Revenue

	Six Months Ended June 30,						Period-to-Period Change	
	2016		2015		Amount	Percentage	Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue				
	(in thousands)							
Software services	\$ 100,013	88.8 %	\$ 75,881	88.9 %	\$ 24,132	31.8 %		
Professional services	12,653	11.2	9,496	11.1	3,157	33.2		
Total revenue	\$ 112,666	100.0 %	\$ 85,377	100.0 %	\$ 27,289	32.0 %		

Growth in software services revenue in absolute terms was primarily attributable to volume increases with existing customers and the net addition of new customers, as the number of large employer and carrier customers increased to 856 as of June 30, 2016 from 714 as of June 30, 2015. Additionally, the launch of a new product offering, ACA Management & Reporting, increased software services \$4.4 million during the second quarter. This service is typically billed annually, in advance, and recognized as revenue when the services are provided.

The increase in professional services revenue of \$3.2 million between the six months ended June 30, 2015 and the six months ended June 30, 2016, was attributable to an increase in newly activated customers and products of \$2.3 million, including \$0.7 million related to implementations of our new ACA Management & Reporting product. The remaining increase in professional services revenue of \$0.9 million was related to the delivery of services to existing customers.

### Segment Revenue

	Six Months Ended June 30,						Period-to-Period Change	
	2016			2015			Amount	Percentage
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Amount		
Employer	\$ 68,454	60.8 %		\$ 41,677	48.8 %	\$ 26,777	64.2 %	
Carrier	44,212	39.2		43,700	51.2	512	1.2	
Total revenue	\$ 112,666	100.0 %		\$ 85,377	100.0 %	\$ 27,289	32.0 %	

Growth in employer revenue was primarily attributable to a \$25.5 million increase in our employer software services revenue, driven primarily by an increase in the number of large employer customers using our platform as of June 30, 2016 as compared to June 30, 2015, as well as volume increases from existing customers. Additionally, employer professional services revenue increased \$1.3 million.

The increase in carrier revenue in absolute terms was primarily attributable to a \$1.9 million increase in of professional services revenue offset by a decrease of \$1.3 million in our carrier software services revenue.

### Cost of Revenue

	Six Months Ended June 30,						Period-to-Period Change	
	2016			2015			Amount	Percentage
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Amount		
Cost of revenue	\$ 59,047	52.4 %		\$ 46,103	54.0 %	\$ 12,944	28.1 %	

The increase in cost of revenue in absolute terms was primarily attributable to an \$11.0 million increase in salaries and personnel-related costs for our customer success organization as we support an increased number of large employer customers and professional fees associated with the delivery of a new product offering. This increase included an increase in stock-based compensation of \$0.6 million. Additionally, we experienced an increase of \$1.6 million in depreciation and amortization, technology infrastructure costs and facilities costs to support the growth in headcount.

### Gross Profit

	Six Months Ended June 30,						Period-to-Period Change	
	2016			2015			Amount	Percentage
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Amount		
Software services	\$ 63,929	63.9 %		\$ 48,755	64.3 %	\$ 15,174	31.1 %	
Professional services	(10,310)	(81.5)		(9,481)	(99.8)	(829)	8.7	
Gross profit	\$ 53,619	47.6 %		\$ 39,274	46.0 %	\$ 14,345	36.5 %	

The increase in software services gross profit was driven by a \$24.1 million, or 31.8%, increase in software services revenue. This increase was partially offset by a \$9.0 million, or 33.0%, increase in software services cost of revenue. Software services cost of revenue included \$0.7 million and \$0.4 million of stock-based compensation expense for the six months ended June 30, 2016 and 2015, respectively, and \$4.2 million and \$3.9 million of depreciation and amortization in each of the six months ended June 30, 2016 and 2015, respectively.

The increase in professional services gross loss was driven by a \$3.2 million, or 33.2%, increase in professional services revenue, partially offset by a \$4.0 million, or 21.0%, increase in professional services cost of revenue. Professional services cost of revenue included \$0.6 million and \$0.4 million of stock-based compensation expense for the six months ended June 30, 2016 and 2015, respectively. In addition, professional services cost of revenue included \$0.7 million and \$0.6 million in depreciation and amortization for the six months ended June 30,

2016 and 2015, respectively. As discussed in “Components of Operating Results—Cost of Revenue”, our cost of revenue is expensed as we incur the costs.

### Segment Gross Profit

	Six Months Ended June 30,						
	2016			2015			
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	Period-to-Period Change	
(in thousands)							
						Amount	Percentage
Employer	\$ 27,551	40.2 %	\$ 16,125	38.7 %	\$ 11,426	70.9 %	
Carrier	26,068	59.0	23,149	53.0	2,919	12.6	
Gross profit	\$ 53,619	47.6 %	\$ 39,274	46.0 %	\$ 14,345	36.5 %	

Employer gross profit increased by \$11.4 million, or 70.9%, between the six months ended June 30, 2015 and June 30, 2016. The \$26.8 million, or 64.2%, increase in employer revenue was partially offset by a \$15.4 million, or 60.1%, increase in employer cost of revenue. The increase in cost of revenue is primarily attributable an increase in associate headcount in our customer success organization which provides support and implementation services to our expanding customer base and professional fees associated with the delivery of our recently launched product, ACA Management & Reporting. Our employer gross profit included \$0.9 million and \$0.4 million of stock-based compensation expense for the six months ended June 30, 2016 and 2015, respectively. In addition, our employer gross profit included \$2.8 million and \$2.1 million of depreciation and amortization for the six months ended June 30, 2016 and 2015, respectively.

Carrier gross profit increased by \$2.9 million, or 12.6%, between the six months ended June 30, 2015 and the six months ended June 30, 2016. Carrier revenue increased \$0.5 million, or 1.2% in addition to a decrease in carrier cost of revenue of \$2.4 million, or 11.7%. The decrease in cost of revenue is primarily attributable to a decrease in carrier customer-specific development and an increase in platform enhancements and development, which is treated as a research and development cost. Our carrier gross profit included \$0.4 million and \$0.3 million of stock-based compensation expense for the six months ended June 30, 2016 and 2015, respectively. In addition, our carrier gross profit included \$2.0 million and \$2.3 million in depreciation and amortization for the six months ended June 30, 2016 and 2015, respectively.

### Operating Expenses

	Six Months Ended June 30,						
	2016			2015			
	Amount	Percentage of Revenue		Amount	Percentage of Revenue	Period-to-Period Change	
(in thousands)							
						Amount	Percentage
Sales and marketing	\$ 28,335	25.1 %	\$ 31,279	36.6 %	\$ (2,944)	(9.4) %	
Research and development	\$ 29,195	25.9 %	\$ 25,048	29.3 %	\$ 4,147	16.6 %	
General and administrative	\$ 16,669	14.8 %	\$ 11,804	13.8 %	\$ 4,865	41.2 %	

The decrease in sales and marketing expense was primarily attributable to a \$1.1 million decrease in salaries and personnel-related costs due to a decrease in the number of sales support and marketing associates, the departure of the Chief Commercial Officer, and a decrease in compensation associated with a large sales deal in 2015. A further decrease of \$0.9 million is associated with travel-related costs and a decrease of \$0.9 million in professional fees and other operating costs.

The increase in research and development expense was primarily attributable to a \$3.2 million increase in salaries and personnel-related costs due to additional research and development headcount. Included in this increase is an increase in stock-based compensation of \$1.5 million that is comprised of \$0.5 million for the accrual of separation benefits related to the departure of the former Chief Technology Officer and \$1.0 million attributable to equity awards granted to new and existing research and development associates. Additionally, we experienced a \$0.5 million increase in engineering consulting fees for assistance in product development and a \$0.4 million increase in technology infrastructure costs.

The increase in general and administrative expense was primarily attributable to a \$3.8 million increase in salaries and personnel-related costs due to additional general and administrative headcount and the accrual of separation benefits related to the departure of the former Chief Financial Officer. Included in this increase is an increase in stock-based compensation of \$2.1 million comprised of \$1.8 million attributable to equity awards granted to new and existing general and administrative associates and \$0.3 million for the accrual of separation benefits related to the departure of the former Chief Financial Officer. We also experienced a \$0.4 million increase in

consulting and professional fees primarily related to the implementation of our enterprise resource planning system, which went live in January 2016 and a \$0.6 million increase in facilities costs, depreciation expense and technology infrastructure costs.

### Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses. In accordance with GAAP, we base our estimates on historical experience and on various other assumptions that we believe reasonable under the circumstances. Actual results might differ from these estimates under different assumptions or conditions and, to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. Except for those listed below, during the six months ended June 30, 2016 there were no material changes to our critical accounting policies and use of estimates, which are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

### Liquidity and Capital Resources

#### Sources of Liquidity

As of June 30, 2016, our primary sources of liquidity were our cash and cash equivalents totaling \$56.9 million and \$11.1 million in marketable securities, \$31.3 million in accounts receivables, net of allowances, and an unused revolving line of credit of \$20.8 million.

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

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

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

#### Financing and Capital Lease Obligations

In January 2016, we entered into a capital lease and financing obligation for data security equipment and software and support. Total payments under the agreement are \$1.9 million including a down payment of \$0.4 million and aggregate monthly payments of \$1.5 million which commenced in March 2016 for a term of 24 months.

In May 2016, we modified an existing capital lease and financing obligation for software licenses and support to extend the term 36 months. Total payments under the modified agreement are \$7.6 million. The agreement specifies various payments totaling \$1.2 million to be made during the remainder of 2016 and an aggregate of \$6.4 million to be made in nine quarterly payments starting in March 2017 and ending May 2019.

### Cash Flows

The following table summarizes our cash flows for the periods indicated:

	<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>
	(in thousands)	
Cash (used in) provided by:		
Operating activities	\$ (20,236)	\$ (16,639)
Investing activities	24,257	(51,098)
Financing activities	4,834	57,087

### *Operating Activities*

For the six months ended June 30, 2016 our operating activities used \$20.2 million of cash, as \$18.9 million for non-cash adjustments and were more than offset by \$14.8 million of cash used in changes in working capital and a net loss of \$24.4 million. Adjustments for non-cash items primarily consisted of depreciation and amortization expense of \$6.3 million, accrual of interest on financing obligations of \$3.4 million, and non-cash stock compensation expense of \$9.2 million. The cash used in changes in working capital primarily consisted of a decrease in deferred revenue of \$9.9 million, a decrease in accrued compensation and benefits of \$3.2 million as the result of switching to a payroll service in the third quarter of 2015, an increase in accounts receivable of \$1.6 million and a decrease in accounts payable not associated with the purchase of property and equity of \$1.3 million. Changes in working capital that provided cash totaled \$1.0 million were comprised of a decrease of accrued expenses and other non-current assets not associated with the purchase of property and equipment.

For the six months ended June 30, 2015, our operating activities used \$16.6 million of cash, as \$14.0 million for non-cash adjustments and \$2.3 million of cash used by changes in working capital was more than offset by a net loss of \$32.9 million. Adjustments for non-cash items primarily consisted of depreciation and amortization expense of \$5.7 million, accrual of interest on financing obligations of \$3.6 million, and non-cash stock compensation expense of \$4.6 million. The cash provided by changes in working capital primarily consisted of an increase in accrued compensation and benefits of \$1.9 million, an increase in accounts payable of \$1.4 million, an increase in accrued expenses of \$0.6 million, and a decrease in other non-current assets of \$0.7 million. The fluctuations of accounts payable, accrued expenses, and other non-current assets resulted from normal timing of payments. These increases were more offset by an increase in prepaid expenses and other current assets of \$1.5 million, an increase in accounts receivable of \$0.6 million and a decrease in deferred revenue of \$0.5 million, primarily driven by the change in the customer relationship period. The increase in accounts receivable is due to the timing of customer payments, and the increase in prepaid expenses and other current assets is due to the timing of purchases.

### *Investing Activities*

For the six months ended June 30, 2016 and 2015, net cash used in investing activities was \$2.0 million and \$51.1 million, respectively, for the purchase of short-term investments held to maturity and \$5.0 million and \$8.1 million, respectively, for the purchase of property and equipment. Additionally, during the six months ended June 30, 2016 and 2015, the maturity of short-term investments held to maturity provided \$31.2 million and \$8.1 million, respectively.

### *Financing Activities*

For the six months ended June 30, 2016, net cash provided by financing activities was \$4.8 million, consisting primarily of \$34.0 million in draws on the revolving line of credit and \$1.6 million from stock option exercises. These were offset by payments on the revolving line of credit of \$25.0 million, payments of \$5.6 million of financing and capital lease obligations, and payments of \$0.2 million for the remittance of taxes upon the vesting of restricted stock units.

During the first half of 2016, we changed our method of settling tax liabilities associated with the vesting of restricted stock units. Starting with the April 1, 2016 vest date, we settle the tax liability by selling shares to cover the tax liability in the market which results in no cash outflow from the Company related to the vesting of restricted stock.

For the six months ended June 30, 2015, net cash provided by financing activities was \$57.1 million, consisting primarily of proceeds of \$74.5 million from the issuance of common stock and a warrant to Mercer and a \$22.5 million draw on the revolving line of credit, offset by payments on the revolving line of credit of \$34.9 million, payments of \$4.9 million of financing and capital lease obligations, payments of \$0.9 million for the remittance of taxes upon the vesting of restricted stock units, and payments of \$0.6 million for debt issuance costs related to the establishment of the revolving line of credit.

### **Commitments**

In March 2016, we amended our office lease in Jenks, Oklahoma to extend the term one year starting on May 1, 2016. Expenses related to this lease total \$49,000 per quarter.

In February 2015, we replaced our then existing revolving line of credit with a senior revolving line of credit involving a syndicate of lenders led by Silicon Valley Bank (as amended in March 2016). Our current revolving line of credit has a borrowing limit of \$60.0 million. Borrowing capacity under the revolving line of credit is subject to a borrowing base limit that is a function of our monthly recurring revenue as adjusted to reflect lost customer revenue during the previous three calendar months. Therefore, credit available under the revolving line of credit may be less

than the \$60.0 million borrowing limit. The outstanding indebtedness under our previous line of credit was repaid with proceeds from our current credit facility. Interest is payable monthly. Advances under the revolving line of credit bear interest at the prime rate as published in the Wall Street Journal plus a margin based on our liquidity that ranges between 1.0% and 1.5%. We are charged for amounts unused under this arrangement at a rate based on our liquidity of 0.300% to 0.375% per year. Any outstanding principal is due at the end of the term.

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

As of June 30, 2016, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K of the Securities Act, such as the use of unconsolidated subsidiaries, structured finance, special purpose entities or variable interest entities.

### **Recent Accounting Pronouncements**

In June 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-13: Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The purpose of this ASU is to require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This ASU is effective for interim and annual reporting periods beginning after December 15, 2019. We are currently evaluating the impact of this guidance on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09: Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment Accounting. The amendments in this update simplify several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 will be effective for us beginning January 1, 2017, but early adoption is permitted. We are currently evaluating the impact of this update on our results of operations.

In February 2016, the FASB issued ASU No. 2016-02: Leases (Topic 842). The amendments in this update require lessees, among other things, to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous authoritative guidance. This update also introduces new disclosure requirements for leasing arrangements. ASU 2016-02 will be effective for us beginning January 1, 2019, but early adoption is permitted. We are currently evaluating the impact of this update on our financial position and results of operations.

In May 2014, the FASB issued ASU No. 2014-09: Revenue from Contracts with Customers (Topic 606), which amends the revenue recognition requirements in the FASB Accounting Standards Codification and various clarifying updates. This statement requires 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 statement shall be applied using one of two methods: retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying this statement recognized at the date of initial application. We have not yet determined which method it will apply. This guidance will be effective for us beginning January 1, 2018, with an option to early adopt. We are currently evaluating the impact of this guidance on our consolidated financial position and results of operations.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

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

We are exposed to market risk related to changes in interest rates. Borrowings under our revolving line of credit bear interest at rates that are variable. Increases in the Prime Rate would increase the revolving line of credit.

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

We are subject to interest rate risk in connection with borrowings under the revolving line of credit, which are subject to a variable interest rate. At June 30, 2016, we had borrowings under the revolving line of credit of \$39.2 million. As a result, each change of one percentage point in interest rates would result in an approximate \$0.4 million change in our annual interest expense on our outstanding borrowings at June 30, 2016. Any debt we incur in the future may also bear interest at variable rates.

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

We do not believe that inflation has had a material effect on our business, financial condition, or results of operations. We continue to monitor the impact of inflation in order to minimize its effects through pricing strategies, productivity improvements and cost reductions. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition, and results of operations.

#### **ITEM 4. CONTROLS AND PROCEDURES**

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

Under the supervision and with the participation of our management, including Shawn A. Jenkins, our Chief Executive Officer (principal executive officer), and Raymond A. August, our President and Chief Operating Officer (principal financial and accounting officer), we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report.

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

Based on their evaluation, our principal executive officer and principal financial and accounting officer concluded that as of June 30, 2016 our disclosure controls and procedures were designed to, and were effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and our principal financial and accounting officer, as appropriate, to allow timely decisions regarding required disclosures as of June 30, 2016.

##### **(b) Changes in Internal Control Over Financial Reporting**

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

## PART II. OTHER INFORMATION

### ITEM 1A. RISK FACTORS

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

#### Risks Related to Our Business

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

We experienced net losses of \$62.1 million, \$63.2 million, and \$30.4 million for the years ended December 31, 2015, 2014, and 2013, respectively, and net losses of \$24.4 million and \$32.9 million for the six months ended June 30, 2016 and 2015, respectively. We cannot assure that if we will achieve sustained profitability in the near future or at all. We expect to make significant future expenditures to develop and expand our business. In addition, as a public company, we incur significant legal, accounting, and other expenses. These expenditures might make it harder for us to achieve and maintain future profitability. Our recent growth in revenue and number of customers might not be sustainable, and we might not achieve sufficient revenue to achieve or maintain profitability. We could incur significant losses in the future for a number of reasons, including the other risks described in this Quarterly Report on Form 10-Q, and we may encounter unforeseen expenses, difficulties, complications and delays and other unknown events. Accordingly, we might not be able to achieve or maintain profitability and we may incur significant losses for the foreseeable future.

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

Our quarterly operating results might fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis might not be meaningful. You should not rely on our past results as indicative of our future performance. Moreover, our stock price might be based on expectations of future performance that are unrealistic or that we might not meet and, if our revenue or operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. For example, on July 29, 2016, the first trading day after we publically announced the resignation of our recently hired Chief Financial Officer, our stock price dropped almost \$1.50 per share, or 3.4%, to \$43.00.

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

- our ability to hire and retain qualified personnel, including the rate of expansion of our sales force;
- the extent to which our products and services achieve or maintain market acceptance;
- our ability to introduce new products and services and enhancements to our existing products and services on a timely basis;
- new competitors and the introduction of enhanced products and services from competitors;
- the financial condition of our current and potential customers;
- changes in customer budgets and procurement policies;
- the amount and timing of our investment in research and development activities;
- technical difficulties with our products or interruptions in our services;
- changes in the regulatory environment related to benefits and healthcare;
- regulatory compliance costs;
- the timing, size, and integration success of potential future acquisitions; and
- unforeseen legal expenses, including litigation and settlement costs.

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

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

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

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

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

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

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

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

Our success depends largely upon the continued services of our key executive officers. We also rely on our leadership team in the areas of research and development, marketing, services, and general and administrative functions, and on mission-critical individual contributors in research and development. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. For example, in 2015 three of our executive officers announced they were leaving the Company or transitioned into different roles, and in 2016 we hired a new Chief Technology Officer and a new Chief Financial Officer who subsequently resigned for family reasons. The loss of one or more of our executive officers or key associates could have a serious adverse effect on our business.

To continue to execute our growth strategy, we also must attract and retain highly skilled personnel. Competition is intense for engineers with high levels of experience in designing and developing software and Internet-related services. We might not be successful in maintaining our unique culture and continuing to attract and retain qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled personnel with appropriate qualifications. The pool of qualified personnel with SaaS experience and/or experience working with the benefits market is limited overall and specifically

in Charleston, South Carolina, where our principal office is located. In addition, many of the companies with which we compete for experienced personnel have greater resources than we have and are located in geographic areas, like Silicon Valley, that may attract more qualified technology workers.

In addition, in making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the equity awards they are to receive in connection with their employment. Volatility in the price of our stock might, therefore, adversely affect our ability to attract or retain highly skilled personnel. Furthermore, the requirement to expense certain stock awards might discourage us from granting the size or type of stock awards that job candidates require to join our company. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

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

The benefits management software market is highly competitive and is likely to attract increased competition, which could make it hard for us to succeed. Small, specialized providers continue to become more sophisticated and effective. In addition, large, well-financed, and technologically sophisticated software companies might focus more on our market. The size and financial strength of these entities is increasing as a result of continued consolidation in both the IT and healthcare industries. We expect large integrated software companies to become more active in our market, both through acquisitions and internal investment. In addition, insurance carriers may seek to bring certain of their benefits software solutions in-house, whether through acquisitions or internal investment. For example, Aetna, a customer of ours, owns bswift, a provider of insurance exchange technology solutions and benefits administration technology solutions and services. If Aetna were to decide to use bswift's solution in place of any portion of the solutions we currently provide to them, then our business and operating results could be materially and adversely affected. As costs fall and technology improves, increased market saturation might change the competitive landscape in favor of our competitors.

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

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

The cloud-based benefits management software market is relatively new and unproven, and it is uncertain whether it will achieve and sustain high levels of demand and market acceptance. Our success will depend to a substantial extent on the willingness of employers, carriers, and consumers to increase their use of benefits management software. Many employers and carriers have invested substantial personnel and financial resources to integrate internally developed solutions or traditional enterprise software into their businesses for benefits management, and therefore might be reluctant or unwilling to migrate to our cloud-based solutions. Furthermore, some businesses might be reluctant to use cloud-based solutions because they have concerns about the security of their data and the reliability of the technology delivery model associated with these solutions. If employers, carriers and consumers do not perceive the benefits of our solutions, then our market might not develop at all, or it might develop more slowly than we expect, either of which could significantly adversely affect our operating results. In addition, we have limited insight into trends that might develop and affect our business. We might make errors in predicting and reacting to relevant business trends, which could harm our business. If any of these risks occur, it could materially adversely affect our business, financial condition or results of operations.

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

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

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

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

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

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

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

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

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

Our ten largest customers by revenue in the past three years accounted for approximately 42.4%, 40.4% and 47.4% of our consolidated revenue in each of 2015, 2014 and 2013, respectively. Our largest customer by revenue in the past three years accounted for approximately 9.7%, 9.4% and 9.5% of our revenue in each of 2015, 2014 and 2013, respectively. In addition, one customer represented 22.2% of our accounts receivable at December 31, 2015 and another represented 13.3% at December 31, 2014. If any of our large customers or strategic partners

decides not to renew its contracts with us, or to renew on less favorable terms, our business, revenues, reputation, and our ability to obtain new customers could be materially and adversely affected.

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

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

- failure of our customers to adopt or maintain effective business practices;
- changes in the nature or operations of our customers;
- government regulations; and
- increased competition or other changes in the benefits marketplace.

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

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

We have been experiencing a period of rapid growth, which puts strain on our business. To manage this and our anticipated future growth effectively, we must continue to maintain and enhance our IT infrastructure, financial and accounting systems, and controls. We also must attract, train, and retain a significant number of qualified sales and marketing personnel, customer support personnel, professional services personnel, software engineers, technical personnel, and management personnel. Failure to effectively manage our rapid growth could lead us to over-invest or under-invest in development and operations, result in weaknesses in our infrastructure, systems, or controls, give rise to operational mistakes, losses, loss of productivity or business opportunities, and result in loss of employees and reduced productivity of remaining employees. Our growth could require significant capital expenditures and might divert financial resources from other projects such as the development of new products and services. If our management is unable to effectively manage our growth, our expenses might increase more than expected, our revenue could decline or might grow more slowly than expected, and we might be unable to implement our business strategy. The quality of our products and services might suffer, which could negatively affect our reputation and harm our ability to retain and attract customers.

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

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

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

We believe that maintaining awareness of our brand in a cost-effective manner is critical to continuing the widespread acceptance of our existing solutions and is an important element in attracting new customers. Furthermore, we believe that the importance of brand recognition will increase as competition in our market increases. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful services at competitive prices. Our efforts to build, maintain and market

changes to our brand and nationally have involved significant expenses. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incur in maintaining our brand. If we fail to successfully maintain our brand, or incur substantial expenses in an unsuccessful attempt to maintain our brand, we may fail to attract enough new customers or retain our existing customers to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

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

In order to grow our business, we anticipate that we will continue to depend on our relationships with third parties, including Mercer LLC, or Mercer, and its affiliates, and others such as technology and content providers, and third party system integrators. Identifying partners, and negotiating and documenting relationships with them, requires significant time and resources. Our expanded relationship with and February 2015 sale of stock to Mercer increases our reliance on it and related risks, including Mercer's competitors being less likely to do business with us. Our competitors might be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our products and services. In addition, acquisitions of our partners by our competitors could result in a decrease in the number of our current and potential customers, as our partners may no longer facilitate the adoption of our applications by potential customers. If we are unsuccessful in establishing or maintaining our relationships with third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results may suffer. Even if we are successful, we cannot assure you that these relationships will result in increased customer use of our applications or increased revenue.

***If we are required to collect sales and use taxes in additional jurisdictions, we might be subject to liability for past sales and our future sales may decrease.***

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

Vendors of services, like us, are typically held responsible by taxing authorities for the collection and payment of any applicable sales and similar taxes. If one or more taxing authorities determines that taxes should have, but have not, been paid with respect to our services, we might be liable for past taxes in addition to taxes going forward. Liability for past taxes might also include substantial interest and penalty charges. Our customer contracts typically provide that our customers must pay all applicable sales and similar taxes. Nevertheless, our customers might be reluctant to pay back taxes and might refuse responsibility for interest or penalties associated with those taxes. If we are required to collect and pay back taxes and the associated interest and penalties, and if our clients fail or refuse to reimburse us for all or a portion of these amounts, we will incur unplanned expenses that may be substantial. Moreover, imposition of such taxes on us going forward will effectively increase the cost of our software and services to our customers and might adversely affect our ability to retain existing customers or to gain new customers in the areas in which such taxes are imposed.

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

As of December 31, 2015, we had federal and state net operating loss carryforwards due to prior period losses, which if not utilized will begin to expire in 2022 for federal and state purposes. We also have South Carolina jobs tax credit and headquarters tax credit carryforwards, which if not utilized will begin to expire in 2020. These tax credit carryforwards could expire unused and be unavailable to offset future income tax liabilities, which could adversely affect our profitability.

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

ownership change, could have a material effect on the use of our net operating loss carryforwards or other tax attributes, which could adversely affect our profitability.

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

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

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

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

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

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

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

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

***We might require additional capital to support business growth.***

We intend to continue to make investments to support our business growth and might require additional funds to respond to business challenges or opportunities, including the need to develop new products and services or enhance our existing services, enhance our operating infrastructure, and acquire complementary businesses and technologies. Accordingly, we might need to engage in equity or debt financings to secure additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which might make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we might not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

***If we fail to meet our current credit facility's financial covenants, our business and financial condition could be adversely affected.***

Our current credit facility contains financial covenants, including covenants related to financial liquidity and EBITDA. If at any point we fail to comply with the financial covenants, the lenders can demand immediate repayment of our outstanding balance and deny future borrowings under the credit facility. This could have a negative impact on our liquidity, thereby reducing the availability of cash flow for other purposes and adversely affecting our business.

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

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

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

As part of our business strategy, we might acquire, enter into joint ventures with, or make investments in complementary companies, services, and technologies in the future. For example, in 2010, we acquired the intellectual property assets of BeliefNetworks, Inc. We spent considerable time, effort, and money pursuing this company and successfully integrating it into our business. Acquisitions and investments involve numerous risks, including:

- difficulties in identifying and acquiring products, technologies or businesses that will help our business;
- difficulties in integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- risk of entering new markets in which we have little to no experience; and
- delays in customer purchases due to uncertainty and the inability to maintain relationships with customers of the acquired businesses.

If we fail to properly evaluate acquisitions or investments, we might not achieve the anticipated benefits of any such acquisitions, we might incur costs in excess of what we anticipate, and management resources and attention might be diverted from other necessary or valuable activities.

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

An element of our growth strategy is to expand internationally. Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic, and political risks that are different from those in the United States. Because of our limited experience with international operations, our

international expansion efforts might not be successful in creating demand for our products and services outside of the United States or in effectively selling our solutions in the international markets we enter. In addition, we will face risks in doing business internationally that could adversely affect our business, including:

- unstable regional political and economic conditions, such as those caused by the recent vote by the U.K. to exit from the European Union;
- the need to localize and adapt our solutions for specific countries, including translation into foreign languages and associated expenses;
- data privacy laws which require that customer data be stored and processed in a designated territory;
- difficulties in staffing and managing foreign operations;
- different pricing environments, longer sales cycles and longer accounts receivable payment cycles and collections issues;
- new and different sources of competition;
- weaker protection for intellectual property and other legal rights than in the United States and practical difficulties in enforcing intellectual property and other rights outside of the United States;
- laws and business practices favoring local competitors;
- compliance challenges related to the complexity of multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy, and data protection laws and regulations;
- increased financial accounting and reporting burdens and complexities;
- restrictions on the transfer of funds; and
- adverse tax consequences.

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

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

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

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

In addition, we rely on various third parties, including employers' HR departments, carriers, and other third-party service providers and consumers themselves, as users of our system for key activities to protect and promote the security of our systems and the data and information accessible within them, such as administration of enrollment, consumer status changes, claims, and billing. On occasion, people have failed to perform these activities. For example, employers sometimes have failed to terminate the login/password of former employees, or permitted current employees to share login/passwords. When we become aware of such breaches, we work with employers to terminate inappropriate access and provide additional instruction in order to avoid the reoccurrence of such problems. Although to date these breaches have not resulted in claims against us or in material harm to our business, failures to perform these activities might result in claims against us, which could expose us to significant expense, legal liability, and harm to our reputation, which might result in loss of business.

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

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

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

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

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

Moreover, benefits management software as complex as ours has in the past contained, and may in the future contain, or develop, undetected defects or errors. Material performance problems or defects in our products and services might arise in the future. Errors might result from the interface of our services with legacy systems and data, which we did not develop and the function of which is outside of our control. Defects or errors might arise in our existing or new software or service processes. Because changes in employer, carrier, and legal requirements and practices relating to benefits are frequent, we are continuously discovering defects and errors in our software and service processes compared against these requirements and practices. Undiscovered vulnerabilities could expose our software to unscrupulous third parties who develop and deploy software programs that could attack our software or result in unauthorized access to customer data. Defects and errors and any failure by us to identify and address them could result in loss of revenue or market share, liability to customers or others, failure to achieve market acceptance or expansion, diversion of development and other resources, injury to our reputation, and increased service and maintenance costs. Defects or errors in our product or service processes might discourage existing or potential customers from purchasing services from us. Correction of defects or errors could prove to be impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability might be substantial and could adversely affect our operating results.

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

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

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

The ability to access the Benefitfocus Platform is critical to our customers. Our operations and facilities are vulnerable to interruption and/or damage from a number of sources, many of which are beyond our control, including, without limitation: (i) power loss and telecommunications failures, (ii) fire, flood, hurricane, and other natural disasters, (iii) software and hardware errors, failures or crashes in our own systems or in other systems, (iv) computer viruses, denial-of-service attacks, hacking and similar disruptive problems in our own systems and in other systems, and (v) civil unrest, war, and/or terrorism. We have implemented various measures to protect against interruptions of customers' access to our platform. If customers' access is interrupted because of problems in the operation of our facilities, we could be exposed to significant claims by customers, particularly if the access interruption is associated

with problems in the timely delivery of funds due to customer or medical information relevant to patient care. Our plans for disaster recovery and business continuity rely on third-party providers of related services. If those vendors fail us at a time when our systems are not operating correctly, we could incur a loss of revenue and liability for failure to fulfill our obligations. Any significant instances of system downtime could negatively affect our reputation and ability to retain customers and sell our services, which would adversely impact our revenue.

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

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

We serve all our customers from two data centers, one located in Raleigh, North Carolina and the other located in Charlotte, North Carolina. While we control and have access to our servers, we do not control the operation of these facilities. The owners of our data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, or if one of our data center operators is acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so. Problems faced by our third-party data center locations, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Our third-party data centers operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy faced by our third-party data centers operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict.

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

- damage from fire, power loss, natural disasters and other force majeure events outside our control;
- communications failures;
- software and hardware errors, failures, and crashes;
- security breaches, computer viruses, hacking, denial-of-service attacks, and similar disruptive problems; and
- other potential interruptions.

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

We exercise limited control over third-party vendors, which increases our vulnerability to problems with technology and information services they provide. Interruptions in our network access and services might in connection with third-party technology and information services reduce our revenue, cause us to issue refunds to customers for prepaid and unused subscription services, subject us to potential liability, or adversely affect our renewal rates. Although we maintain insurance for our business, the coverage under our policies might not be adequate to compensate us for all losses that may occur. In addition, we might not be able to continue to obtain adequate insurance coverage at an acceptable cost, if at all.

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

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

The terms of many open source licenses to which we are subject have not been interpreted by U.S. or foreign courts. Accordingly, there is a risk that those licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our solutions. In that event, we could be required to seek licenses from third parties in order to continue offering our products or solutions, to re-develop our products or solutions, to discontinue sales of our products or solutions, or to release our proprietary software code under the terms of an open source license, any of which could harm our business. Further, given the nature of open source software, it may be more likely that third parties might assert copyright and other intellectual property infringement claims against us based on our use of these open source software programs.

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

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

The employee benefits industry is highly regulated and is subject to changing political, legislative, regulatory, and other influences. The outcome of the U.S. presidential and other elections in 2016 could have a significant impact on the regulatory environment in our industry. Existing and new laws and regulations affecting the employee benefits industry could create unexpected liabilities for us, cause us to incur additional costs and restrict our operations. These laws and regulations are complex and their application to specific services and relationships are not clear. In particular, many existing laws and regulations affecting employee benefits, when enacted, did not anticipate the services that we provide, and these laws and regulations might be applied to our services in ways that we do not anticipate. Our failure to accurately anticipate the application of these laws and regulations, or our failure to comply, could create liability for us, result in adverse publicity, and negatively affect our business. Some of the risks we face from the regulation of employee benefits are as follows:

- PPACA. Governmental oversight punctuated with the passage of the Patient Protection and Affordable Care Act, or PPACA, has led to an increasingly intricate regulatory framework under which health benefits are obtained, delivered, accessed, and maintained. Although many of the provisions of PPACA do not directly apply to us, PPACA might affect the business of many of our customers. Carriers and large employers might experience changes in the numbers of individuals they insure as a result of Medicaid expansion and the creation of state and national exchanges under PPACA and state Medicaid expansion, though it is unclear how many states will decline to implement the Medicaid expansion or adopt state-specific exchanges. Although we are unable to predict with any reasonable certainty or otherwise quantify the likely impact of PPACA on our business model, financial condition, or results of operations, changes in the business of our customers and the number of individuals they insure may negatively impact our business. Congress also has repeatedly but unsuccessfully attempted to repeal PPACA and we are unable to predict the impact of any such pending or future attempts.

- **False or Fraudulent Claim Laws.** There are numerous federal and state laws that forbid submission of false information or the failure to disclose information in connection with submission and payment of claims for reimbursement from the government. In some cases, these laws also forbid abuse of existing systems for such submission and payment. Although our business operations are generally not subject to these laws and regulations, any contract we have with a government entity requires us to comply with these laws and regulations. Any failure of our services to comply with these laws and regulations could result in substantial liability, including but not limited to criminal liability, could adversely affect demand for our services, and could force us to expend significant capital, research and development, and other resources to address the failure. Any determination by a court or regulatory agency that our services with government clients violate these laws and regulations could subject us to civil or criminal penalties, invalidate all or portions of some of our government client contracts, require us to change or terminate some portions of our business, require us to refund portions of our services fees, cause us to be disqualified from serving not only government clients but also all clients doing business with government payers, and have an adverse effect on our business.
- **HIPAA and Other Privacy and Security Requirements.** There are numerous U.S. federal and state laws and regulations related to the privacy and security of personal health information. In particular, regulations promulgated pursuant to Health Insurance Portability and Accountability Act of 1996, or HIPAA, established privacy and security standards that limit the use and disclosure of individually identifiable health information, and require the implementation of administrative, physical, and technological safeguards to ensure the confidentiality, integrity, and availability of individually identifiable health information in electronic form. Health plans, healthcare clearinghouses, and most providers are considered by the HIPAA regulations to be "Covered Entities". With respect to our operations as a healthcare clearinghouse, we are directly subject to the privacy regulations established under HIPAA, or Privacy Standards, and the security regulations established under HIPAA, or Security Standards. In addition, our carrier customers, or payors, are considered to be Covered Entities and are required to enter into written agreements with us, known as Business Associate Agreements, under which we are considered to be a "Business Associate" and that require us to safeguard individually identifiable health information and restrict how we may use and disclose such information. The American Recovery and Reinvestment Act of 2009, or ARRA, and the HIPAA Omnibus Final Rules extended the direct application of certain provisions of the Privacy Standards and Security Standards to us when we are functioning as a Business Associate of our carrier customers. ARRA and the HIPAA Omnibus Final Rule also subject Business Associates to direct oversight and audit by the Department of Health and Human Services.

Violations of the Privacy Standards and Security Standards might result in civil and criminal penalties, and ARRA increased the penalties for HIPAA violations and strengthened the enforcement provisions of HIPAA. For example, ARRA authorizes state attorneys general to bring civil actions seeking either injunctions or damages in response to violations of Privacy Standards and Security Standards that threaten the privacy of state residents. Moreover, the U.S. Department of Health and Human Services' Office for Civil Rights ("OCR") recently launched a formal HIPAA audit program. The audits are intended to assess compliance with HIPAA by both Covered Entities and Business Associates and will be conducted by OCR with assistance from a third party vendor. Issues identified during the audits may result in agency-imposed corrective action plans or civil monetary penalties.

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

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

In addition to the Privacy Standards and Security Standards, most states have enacted patient confidentiality laws that protect against the disclosure of confidential medical and/or health information, and many states have adopted or are considering further legislation in this area, including privacy safeguards, security standards, and data security breach notification requirements. Such state laws, if more stringent than HIPAA requirements, are not preempted by the federal requirements and we are required to comply with them. Failure by us to comply with any state standards regarding patient privacy may subject us to penalties, including civil monetary penalties and, in some circumstances, criminal penalties. Such failure may injure our reputation and adversely affect our ability to retain customers and attract new customers.

- Medicare and Medicaid Regulatory Requirements. We have contracts with insurance carriers who offer Medicare Managed Care (also known as Medicare Advantage or Medicare Part C) and Medicaid Managed Care benefits plans. We also have contracts with insurance carriers who offer Medicare prescription drug benefits (also known as Medicare Part D) plans. The activities of the Medicare plans are regulated by the Centers for Medicare & Medicaid Services, or CMS, the federal agency that provides oversight of the Medicare and Medicaid programs. The Medicaid Managed Care plans are regulated by both CMS and the individual states where the plans are offered. Some of the activities that we might perform, such as the enrollment of beneficiaries, may be subject to CMS and/or state regulation, and such regulations may force us to change the way we do business or otherwise restrict our ability to provide services to such plans. Moreover, the regulatory environment with respect to these programs has become, and will likely continue to become, increasingly complex.
- Financial Services-Related Laws and Rules. Financial services and electronic payment processing services are subject to numerous laws, regulations and industry standards, some of which might impact our operations and subject us, our vendors, and our customers to liability as a result of the payment distribution and processing solutions we offer. Although we do not act as a bank, we offer solutions that involve banks, or vendors who contract with banks and other regulated providers of financial services. As a result, we might be impacted by banking and financial services industry laws, regulations, and industry standards, such as licensing requirements, solvency standards, requirements to maintain the privacy and security of nonpublic personal financial information, and Federal Deposit Insurance Corporation deposit insurance limits. In addition, our patient billing and payment distribution and processing solutions might be impacted by payment card association operating rules, certification requirements, and rules governing electronic funds transfers. If we fail to comply with applicable payment processing rules or requirements, we might be subject to fines and changes in transaction fees and may lose our ability to process credit and debit card transactions or facilitate other types of billing and payment solutions. Moreover, payment transactions processed using the Automated Clearing House are subject to network operating rules promulgated by the National Automated Clearing House Association and to various federal laws regarding such operations, including laws pertaining to electronic funds transfers, and these rules and laws might impact our billing and payment solutions. Further, our solutions might impact the ability of our payor customers to comply with state prompt payment laws. These laws require payors to pay healthcare claims meeting the statutory or regulatory definition of a "clean claim" within a specified time frame.
- Insurance Broker Laws. Insurance laws in the United States are often complex, and states have broad authority to adopt regulations regarding brokerage activities. These regulations typically include the licensing of insurance brokers and agents and govern the handling and investment of client funds held in a fiduciary capacity. Although we believe our activities do not currently constitute the provision of insurance brokerage services, regulations may change from state to state, which could require us to comply with such expanded regulation.
- ERISA. The Employee Retirement Income Security Act of 1974, as amended, or ERISA, regulates how employee benefits are provided to or through certain types of employer-sponsored health benefits plans. ERISA is a set of laws and regulations that is subject to periodic interpretation by the U.S. Department of Labor as well as the federal courts. In some circumstances, and under certain customer contracts, we might be deemed to have assumed duties that make us an ERISA fiduciary, and thus be required to carry out our operations in a manner that complies with ERISA in all material respects. We believe that our current operations do not render us subject to ERISA fiduciary obligations, and therefore that we are in material compliance with ERISA and that any such compliance does not currently have a material adverse effect on our operations. However, there can be no assurance that continuing ERISA compliance efforts or any future changes to ERISA will not have a material adverse effect on us.
- Third-Party Administrator Laws. Numerous states in which we do business have adopted regulations governing entities engaged in third-party administrator, or TPA, activities. TPA regulations typically impose requirements regarding enrollment into benefits plans, claims processing and payments, and the handling of customer funds. Although we do not believe we are currently acting as a TPA, changes in state regulations could result in us being obligated to comply with such regulations, which might require us to obtain licenses to provide TPA services in such states.

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

The Goldman Sachs Group, affiliates of which owned approximately 21.1% of the voting and economic interest in our business at June 30, 2016, is regulated as a bank holding company and a financial holding company under the Bank Holding Company Act of 1956, as amended, or BHC Act. The BHC Act imposes regulations and requirements on The Goldman Sachs Group and on any company that is deemed to be controlled by The Goldman Sachs Group under the BHC Act and the regulations of the Board of Governors of the Federal Reserve System, or the Federal Reserve. Due to the size of its voting and economic interest, we are deemed to be controlled by The Goldman Sachs Group and are therefore considered to be a non-bank "subsidiary" of The Goldman Sachs Group under the BHC Act. We will remain subject to this regulatory regime until The Goldman Sachs Group is no longer deemed to control us for purposes of the BHC Act, which we do not generally have the ability to control and which will not occur until The Goldman Sachs Group has significantly reduced its voting and economic interest in us.

As a controlled non-bank subsidiary of The Goldman Sachs Group, we are restricted from engaging in activities that are not permissible under the BHC Act, or the rules and regulations promulgated thereunder. Permitted activities for a bank holding company or any controlled non-bank subsidiary generally include activities that the Federal Reserve has previously determined to be closely related to banking, financial in nature or incidental or complementary to financial activities, including data processing services such as those that we provide with our software solutions. Restrictions placed on The Goldman Sachs Group as a result of supervisory or enforcement actions under the BHC Act or otherwise may restrict us or our activities in certain circumstances, even if these actions are unrelated to our conduct or business. Further, as a result of being subject to regulation and supervision by the Federal Reserve, we may be required to obtain the prior approval of the Federal Reserve before engaging in certain new activities or businesses, whether organically or by acquisition. The Federal Reserve could exercise its power to restrict us from engaging in any activity that, in the Federal Reserve's opinion, is unauthorized or constitutes an unsafe or unsound business practice. To the extent that these regulations impose limitations on our business, we could be at a competitive disadvantage because some of our competitors are not subject to these limitations.

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

As a non-bank subsidiary of a bank holding company, we are subject to examination by the Federal Reserve and required to provide information and reports for use by the Federal Reserve under the BHC Act. In addition, we may be subject to regulatory oversight and examination because we are a technology service provider to regulated financial institutions. The Federal Reserve may also impose substantial fines and other penalties for violations of applicable banking laws, regulations and orders. Further, the Dodd-Frank Act, including Title VI thereunder known as the "Volcker Rule", and related financial regulatory reform call for the issuance of numerous regulations designed to increase and strengthen the regulation of bank holding companies, including The Goldman Sachs Group and its affiliates. The Volcker Rule, in relevant part, restricts banking entities from proprietary trading (subject to certain exemptions) and from acquiring or retaining any equity, partnership or other interests in, or sponsoring, a private equity fund, subject to satisfying certain conditions, and from engaging in certain transactions with funds.

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

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

Our products and services are and are likely to continue to be subject to increasing regulatory requirements in a number of ways. As these requirements proliferate, we must change or adapt our products and services to comply. Changing regulatory requirements might render our services obsolete or might block us from accomplishing our work or from developing new services. This might in turn impose additional costs upon us to comply or to further develop our products and services. It might also make introduction of new product or service types more costly or more time-consuming than we currently anticipate. It might even prevent introduction by us of new products or services or cause the continuation of our existing products or services to become unprofitable or impossible.

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

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

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

Among other things, certain services offered by us involve collecting payment information from individuals, and this frequently includes check and credit card information. Even though we do not handle direct payments, our services also involve the use and disclosure of personal and business information that could be used to impersonate third parties, commit identity theft, or otherwise gain access to their data or funds. If any of our associates take, convert, or misuse such funds, documents, or data, we could be liable for damages, and our business reputation could be damaged or destroyed. Moreover, if we fail to adequately prevent third parties from accessing personal and/or business information and using that information to commit identity theft, we might face legal liabilities and other losses that can have a negative impact on our business.

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

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

The stock market historically has experienced extreme price and volume fluctuations. As a result of this volatility, you might not be able to sell your common stock at or above the price at which you purchase it. The public market for our stock is very new. From our IPO in September 2013 through June 30, 2016, the per share trading price of our common stock has been as high as \$77.00 and as low as \$19.58. It might continue to fluctuate significantly in response to various factors, some of which are beyond our control. These factors include:

- any major change in our board of directors or management;
- our operating performance and the operating performance of similar companies;
- the overall performance of the equity markets;
- announcements by us or our competitors of acquisitions, business plans, or commercial relationships;
- threatened or actual litigation;
- changes in laws or regulations relating to the sale of health insurance;
- publication of research reports or news stories about us, our competitors, or our industry, or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- large volumes of sales of our shares of common stock by existing stockholders; and
- general political and economic conditions.

In addition, the stock market in general, and the market for Internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These fluctuations might be even more pronounced in the relatively new trading market for our stock. Additionally, securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. This litigation, if instituted against us, could result in substantial costs, divert our management's attention and resources, and harm our business, operating results, and financial condition.

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

We have never declared or paid any cash dividends on our common stock and do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Therefore, you are not likely to receive any dividends on your common stock for the foreseeable future, and the success of an investment in shares of our common stock will depend upon future appreciation in its value, if any. There is no guarantee that shares of our common stock will appreciate in value or even maintain the price at which our stockholders purchased their shares.

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

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

As of June 30, 2016, we had an aggregate of 29,588,841 shares of common stock outstanding. As of June 30, 2016, there also were outstanding options, restricted stock units and warrants to purchase 3,513,356 shares of our common stock that, if exercised or vested, as applicable, will result in these additional shares becoming available for sale subject in some cases to Rule 144.

On November 12, 2013 and June 7, 2016, we also registered an aggregate of 6,399,766 shares of our common stock that we may issue or sell under our stock plans, including our recently approved Benefitfocus, Inc. 2016 Employee Stock Purchase Plan. These shares can be freely sold in the public market upon issuance, unless they are held by "affiliates", as that term is defined in Rule 144 of the Securities Act. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

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

As of June 30, 2016, our directors, executive officers, and their affiliated entities beneficially owned approximately 44.7% of our outstanding common stock. In particular, GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P., GS Capital Partners VI Fund, L.P., and GS Capital Partners VI GmbH & CO. KG, which are affiliates of Goldman, Sachs & Co. and which we refer to as the Goldman Funds, collectively beneficially owned approximately 21.1%. These stockholders, if they act together, could exert substantial influence over matters requiring approval by our stockholders, including the amendment of our certificate of incorporation and bylaws, and the approval of mergers or other business combination transactions.

Additionally, the Goldman Funds, Oak Investment Partners XII, L.P., Mason R. Holland, Jr., our Executive Chairman and a director, and Shawn A. Jenkins, our Chief Executive Officer and a director, entered into a voting agreement for the election of directors. As of June 30, 2016, these stockholders collectively beneficially owned approximately 44.4% of our common stock. Pursuant to the voting agreement, the parties agree to vote all of their shares to elect two directors nominated by the Goldman Funds, one director nominated by Oak Investment Partners, and each of Messrs. Holland and Jenkins to our board of directors. As a result, these stockholders will have significant influence on the outcome of director elections. This concentration of ownership might discourage, delay, or prevent a change in control of our company, which could deprive our stockholders of an opportunity to receive a premium for their stock as part of a sale of our company and might reduce our stock price. These actions may be taken even if they are opposed by other stockholders.

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

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

- limitations on the removal of directors;
- advance notice requirements for stockholder proposals and nominations;
- limitations on the ability of stockholders to call special meetings;
- the inability of stockholders to act by written consent once The Goldman Sachs Group and its affiliates cease to own at least 35% of our voting equity;
- the inability of stockholders to cumulate votes at any election of directors;
- the classification of our board of directors into three classes with only one class, representing approximately one-third of our directors, standing for election at each annual meeting; and
- the ability of our board of directors to make, alter or repeal our bylaws.

Our Board of Directors has the ability to designate the terms of and issue new series of preferred stock without stockholder approval. In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person which together with its affiliates owns, or within the last three years has owned, 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner.

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

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

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

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. Commencing with our fiscal year ending December 31, 2014, we performed system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our ongoing compliance with Section 404 of the Sarbanes-Oxley Act will require that we incur substantial accounting expense and expend significant management efforts.

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

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

As previously reported, in the first quarter of 2014, we identified a material weakness in internal controls over the accounting for leasing transactions which resulted in the identification of a material error in the accounting for our headquarters lease executed in May 2005. We might in the future discover other material weaknesses that require remediation. In addition, an internal control system, no matter how well-designed, cannot provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud will be detected. If we are not able to comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner, or if we are unable to maintain proper and effective internal controls, we might not be able to produce timely and accurate financial statements. If that were to happen, the market price of our stock could decline and we could be subject to sanctions or investigations by the stock exchange on which our common stock is listed, the SEC, or other regulatory authorities.

Any failure to develop or maintain effective controls, or any difficulties encountered in their implementation or improvement, could harm our operating results or cause us to fail to meet our reporting obligations. Any failure to implement and maintain effective internal controls also could adversely affect the results of periodic management evaluations regarding the effectiveness of our internal control over financial reporting that we are required to include in our periodic reports filed with the SEC under Section 404 of the Sarbanes-Oxley Act. Ineffective disclosure controls and procedures or internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers, and employees, entail substantial costs in order to modify our existing accounting systems, and

take a significant period of time to complete. Such changes may not be effective, however, in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In the event that we are not able to demonstrate compliance with Section 404 of the Sarbanes-Oxley Act in a timely manner, that our internal controls are perceived as inadequate, or that we are unable to produce timely or accurate financial statements, investors may lose confidence in our operating results and our stock price could decline.

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

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

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

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

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

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

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

### **(b) Use of Proceeds from Public Offering of Common Stock**

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

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

There was no material change in the use of proceeds from our IPO as described in our final prospectus filed pursuant to Rule 424(b) of the Securities Act with the SEC on September 18, 2013. As of December 31, 2015, we had used the entire proceeds from our IPO for working capital purposes and other general corporate purposes, including executing our growth strategy, developing new products and services, and funding additional capital expenditures, potential acquisitions, and investments. We also invested the funds received in short-term, interest bearing, investment-grade securities.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Title	Incorporated by Reference (Unless Otherwise Indicated)			
		Form	File	Exhibit	Filing Date
2.1	Agreement and Plan of Merger, dated August 29, 2013 by and among Benefitfocus.com, Inc., Benefitfocus, Inc., and Benefitfocus Mergeco, Inc.	S-1/A	333-190610	2.1	September 5, 2013
3.1.3	Restated Certificate of Incorporation of Benefitfocus, Inc.	10-Q	—	3.1.3	November 12, 2013
3.2	Amended and Restated Bylaws of Benefitfocus, Inc.	S-1/A	333-190610	3.2	September 5, 2013
4.1	Specimen Certificate for Common Stock.	S-1/A	333-190610	4.1	September 5, 2013
4.3	Form of Second Amended and Restated Investors' Rights Agreement, dated , 2013, by and among Benefitfocus, Inc. and certain stockholders named therein.	S-1/A	333-190610	4.3	September 16, 2013
4.3.1	First Amendment to Second Amended and Restated Investors' Rights Agreement, dated February 24, 2015, by and among Benefitfocus, Inc. and certain stockholders named therein.	10-K	—	4.3.1	February 27, 2015
4.5	Warrant for the Purchase of Shares of Common Stock of Benefitfocus, Inc. issued February 24, 2015	10-K	—	4.5	February 27, 2015
10.2	Form of Second Amended and Restated Voting Agreement, dated , 2013, by and among Benefitfocus, Inc., and certain stockholders named therein.	S-1/A	333-190610	10.2	September 5, 2013
10.3	Amended and Restated 2000 Stock Option Plan.#	S-1	333-190610	10.3	August 14, 2013
10.4	2012 Stock Plan, as amended.#	DEF 14A			April 25, 2014
10.5	Form of Grant Notice and Stock Option Agreement under the Amended and Restated 2000 Stock Option Plan.#	S-1	333-190610	10.5	August 14, 2013
10.6	Form of Grant Notice and Stock Option Agreement under the 2012 Stock Plan, as amended.#	S-1	333-190610	10.6	August 14, 2013
10.7	Form of Management Incentive Bonus Program.#	S-1	333-190610	10.7	August 14, 2013
10.7.1	Benefitfocus, Inc. Management Incentive Bonus Program.#	DEF 14A			April 25, 2014
10.11	Form of Employment Agreement.#	S-1	333-190610	10.11	August 14, 2013
10.12	Form of Indemnification Agreement.#	S-1	333-190610	10.12	August 14, 2013
10.27	Benefitfocus, Inc. 2016 Employee Stock Purchase Plan.	DEF 14A			April 22, 2016

31.1	Certification of the Chief Executive Officer (principal executive officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	—	—	—	Filed herewith
31.2	Certification of the President and Chief Operating Officer (principal financial and accounting officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	—	—	—	Filed herewith
32.1	Certification of the Chief Executive Officer (principal executive officer) and President and Chief Operating Officer (principal financial and accounting officer) pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	—	—	—	Filed herewith
101.INS	XBRL Instance Document.	—	—	—	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document.	—	—	—	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.	—	—	—	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.	—	—	—	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.	—	—	—	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.	—	—	—	Filed herewith

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# Management contract or compensatory plan.

**SIGNATURES**

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

Date: August 4, 2016

Benefitfocus, Inc.

By: /s/ Raymond A. August

Raymond A. August  
President and Chief Operating Officer  
(Principal financial and accounting officer)

**EXHIBIT INDEX**

**Incorporated by Reference  
(Unless Otherwise Indicated)**

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# Management contract or compensatory plan.

**CERTIFICATION PURSUANT TO  
SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002**

I, Shawn A. Jenkins, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Benefitfocus, Inc. (the registrant);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

/s/ Shawn A. Jenkins  
Shawn A. Jenkins  
Chief Executive Officer  
(Principal executive officer)

**CERTIFICATION PURSUANT TO  
SECTION 302 OF  
THE SARBANES-OXLEY ACT OF 2002**

I, Raymond A. August, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Benefitfocus, Inc. (the registrant);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2016

/s/ Raymond A. August  
Raymond A. August  
*President and Chief Operating Officer*  
(Principal financial and accounting officer)

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Shawn A. Jenkins, Chief Executive Officer (principal executive officer) of Benefitfocus, Inc. (the "registrant"), and Raymond A. August, President and Chief Operating Officer (principal financial and accounting officer) of the registrant, each hereby certifies that, to the best of their knowledge:

1. The registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2016, to which this Certification is attached as Exhibit 32.1 (the "Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition of the registrant at the end of the period covered by the Report and results of operations of the registrant for the periods covered by the Report.

Date: August 4, 2016

/s/ Shawn A. Jenkins

Shawn A. Jenkins

*Chief Executive Officer*

(Principal executive officer)

/s/ Raymond A. August

Raymond A. August

*President and Chief Operating Officer*

(Principal financial and accounting officer)