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

FORM 10-K

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

For the fiscal year ended June 30, 2019

OR

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

For the Transition Period from to

Commission File Number 001- 36348

PAYLOCITY HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

46-4066644
(I.R.S. Employer
Identification Number)

1400 American Lane
Schaumburg, Illinois 60173
(Address of principal executive offices and zip code)

(847) 463-3200
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, par value \$0.001 per share

Trading symbol(s)
PCTY

Name of Exchange on which registered
The NASDAQ Global Select Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of December 31, 2018, the last day of registrant's most recently completed second fiscal quarter, was \$2.0 billion (based on the closing price for shares of the registrant's common stock as reported by the NASDAQ Global Select Market for the last business day prior to that date).

As of August 2, 2019, there were 53,082,006 shares of the registrant's common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the Proxy Statement relating to the registrant's 2020 annual meeting of stockholders, which shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

PAYLOCITY HOLDING CORPORATION
Form 10-K
For the Year Ended June 30, 2019
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PART 1

Forward Looking Statements

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

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

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

Item 1. Business.

Overview

We are a cloud-based provider of payroll and human capital management, or HCM, software solutions for medium-sized organizations, which we define as those having between 20 and 1,000 employees. Our comprehensive and easy-to-use solutions enable our clients to manage their workforces more effectively. Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2019, we provided our payroll and HCM software solutions to approximately 20,200 clients across the U.S., which on average had over 100 employees.

Our multi-tenant software platform is highly configurable and includes a unified suite of payroll and HCM modules, including core HR, workforce management, talent and benefits, for our clients to make strategic decisions all while promoting a modern workplace and improving employee engagement. Our payroll and HCM modules provide robust on-demand functionality, reporting and analytics. Our platform provides intuitive self-service functionality for employees and managers combined with seamless integration across all our solutions. We supplement our comprehensive software platform with an integrated implementation and client service organization, all of which are designed to meet the needs of medium-sized organizations.

Effective management of human capital is a core function in all organizations and requires a significant commitment of resources. Organizations are faced with complex and ever-changing requirements, including diverse federal, state and local regulations across multiple jurisdictions. In addition, the workplace operating environment is rapidly changing as employees increasingly become mobile, work remotely and expect an end user experience similar to that of consumer-oriented Internet applications. Medium-sized organizations operating without the infrastructure, expertise or personnel of larger enterprises are uniquely pressured in this complex and dynamic environment. Existing solutions offered by third-party payroll service providers can have limited capabilities and configurability while

enterprise-focused software vendors can be expensive and time-consuming to implement and manage. We believe that medium-sized organizations are better served by solutions designed to meet their unique needs.

Our solutions provide the following key benefits to our clients:

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

We market and sell our products through our direct sales force. We generate sales leads through a variety of focused marketing initiatives and from our extensive referral network of 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants. We derive revenue from a client based on the solutions purchased by the client, the number of client employees and the amount, type and timing of services provided with respect to those client employees. Our annual revenue retention rate was greater than 92% in each of the fiscal years 2017, 2018 and 2019. Our total revenues increased from \$300.0 million in fiscal 2017 to \$377.5 million in fiscal 2018, representing a 26% year-over-year increase and to \$467.6 million in fiscal 2019, representing a 24% year-over-year increase. Our recurring revenues increased from \$288.4 million in fiscal 2017 to \$363.5 million in fiscal 2018, representing a 26% year-over-year increase, and to \$456.8 million in fiscal 2019, representing a 26% year-over-year increase. While the majority of our agreements with clients are generally cancellable on 60 days’ or less notice, we also began entering into term agreements in fiscal 2018, which are generally two years in length. Our recurring revenue model provides significant visibility into our future operating results.

Industry Background

Effective management of human capital is a core capability for all organizations. Identifying, acquiring and retaining talent is a priority at all levels of an organization. Likewise, in today’s increasingly complex business and regulatory environment, organizations are being pressured to manage critical payroll and HCM functions more effectively, automate manual processes and decrease their operating costs, while at the same time successfully managing their workforces.

Complex and Dynamic Tax and Regulatory Environment

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

Growing Demand for Mobility and Enhanced User Experience

Connectivity and mobility are enabling employees to spend less time in traditional office environments and more time working remotely. This trend increases the demand for advanced and intuitive solutions that improve collaboration and foster employee engagement, such as remote self-service access to payroll and timesheet reporting, HR

and benefits portals and other talent management applications. Given the prominence of consumer-oriented Internet applications, employees expect the user experience and accessibility of internal systems to be similar to those of the latest Internet applications, such as LinkedIn, Amazon and Facebook.

Large Market Opportunity for Payroll and HCM Solutions

The market opportunity in the U.S. for payroll and HCM applications and services is driven by the importance of payroll and HCM solutions to the successful management of organizations. To estimate our addressable market, we focus our analysis on the number of U.S. medium-sized organizations and the number of their employees. According to the U.S. Census Bureau, there were over 638,000 firms with 20 to 999 employees in the U.S. in 2016, employing over 45 million people. We estimate that if clients were to buy our entire suite of existing solutions at list prices, they would spend approximately \$400 per employee annually. Based on this analysis, we believe our current target addressable market is approximately \$18 billion. Our existing clients do not typically own our entire suite of solutions, and as we continue to expand our product offerings, we believe that we have an opportunity to increase the amount clients spend on payroll and HCM solutions per employee and to expand our addressable market.

Organizations Are Increasingly Transitioning to SaaS Solutions

SaaS solutions are easier and more affordable to implement and operate than those offered by traditional service bureaus and legacy software providers. SaaS solutions also enable software updates with greater frequency and without new hardware investments, enabling organizations to better react to changes in their environments. Many organizations are transitioning to SaaS solutions to satisfy their software needs. Similarly, we believe organizations are adopting SaaS applications for payroll and HCM solutions with increasing frequency.

Limitations of Legacy Competitive Solutions

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

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

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

Segment Information

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

Our Solutions

We are a cloud-based provider of payroll and HCM software solutions for medium-sized organizations. Our solutions enable medium-sized organizations to more efficiently manage payroll and human capital in their complex and dynamic operating environments. Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2019, we provided our payroll and HCM software solutions to approximately 20,200 clients across the U.S., which on average had over 100 employees.

The key benefits of our solutions include the following:

- *Comprehensive Platform Optimized for Medium-Sized Organizations.* Our solutions empower finance and HR professionals in medium-sized organizations to drive strategic human capital decisions by providing enterprise-grade payroll and HCM modules, including robust reporting and analytics. Our unified platform fully automates payroll and HCM processes, enabling our clients to focus on core business activities. Our solutions help our clients attract, retain and manage their employees within a single, comprehensive system.
- *Modern, Intuitive User Experience.* Our intuitive, easy-to-use and mobile-centric platform provides increased accessibility of our solutions and decreased need for training while also providing users with an engaging mobile and self-service experience.
- *Flexible and Configurable Platform.* We design our solutions to be flexible and configurable, allowing our clients to match their use of our software with their specific business processes and workflows. Our platform has been organically developed from a common code-base, data structure and user interface, providing a consistent user experience with powerful features that are easily adaptable to our clients' needs. Our systems centralize payroll and HCM data, minimizing inconsistent and incomplete information that can be produced when using multiple databases.
- *Highly-Attractive SaaS Solution for Medium-Sized Organizations.* Our solutions are cloud-based and offered on a subscription basis, making them easier and more affordable to implement, operate and update and thus enabling our clients to focus less on their IT infrastructure and more on their core businesses. Our software can be operated by a single administrator without the support of an in-house information technology department. Our multi-tenant and modern architecture allows for frequent software enhancements thereby enabling our clients to react to a rapidly changing and complex operating environment. Our platform enables our clients to scale their businesses without having to acquire additional hardware or to resolve the integration challenges that often result from traditional outsourcing solutions.
- *Seamless Integration with Extensive Ecosystem of Partners.* Our platform offers our clients automated data integration with over 300 related third-party partner systems, such as 401(k), benefits and insurance provider systems. This integration reduces the complexity and risk of error of manual data transfers and saves time for our clients and their employees. We integrate data with these related systems through a secure connection, which significantly decreases the risk of unauthorized third-party access and other security breaches. Our direct and automated data transmission improves the accuracy of data and facilitates data collection in our partners' systems. We believe having automated data integration with a payroll and HCM provider like us differentiates our partners' product offerings, strengthening their competitive positioning in their own markets.

Our Strategy

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

- *Grow Our Client Base.* We believe that our current client base represents only a small portion of the medium-sized organizations that could benefit from our solutions. While we provide our payroll and HCM software solutions to approximately 20,200 clients across the U.S. (excluding clients acquired as part of the BeneFLEX acquisition) as of June 30, 2019, there are over 638,000 businesses with 20 to 999 employees in the U.S., employing more than 45 million people, according to the U.S. Census Bureau in 2016. In order to acquire new clients, we plan to continue growing our sales organization across the U.S.
- *Expand Our Product Offerings.* We believe a significant part of our leadership position is the result of our investment and innovation in our product offerings designed for medium-sized organizations. Our average revenue per client has consistently increased in each of the last three years as we have broadened our product offerings. We plan to continue to invest in product development efforts that will allow us to offer a broader selection of products to new and existing clients.
- *Extend Technological Leadership.* We believe that our organically developed cloud-based multi-tenant software platform, combined with our unified database architecture, enhances the experience and usability of our products, providing what we believe to be a competitive advantage over alternative solutions. Our modern, intuitive user interface utilizes features found on many popular consumer Internet sites, enabling users to use our solutions with limited training. We plan to continue our technology innovation, as we have done with our mobile applications, social features and analytics capabilities.
- *Further Develop Our Referral Network.* We have developed a strong network of referral participants, such as 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants that recommend our solutions and provide referrals. We believe that our platform’s automated data integration with over 300 related third-party partner systems is valuable to our referral participants, as they are able to access payroll and HR data through a single system which decreases complexity and cost and complements their own product offerings. We plan to increase integration with third-party providers and expand our referral network to grow our client base and lower our client acquisition costs.

Our Products

Our products include a suite of unified payroll and HCM modules that enable our clients to automate routine tasks, changes and updates across the employee lifecycle, and to manage complex compliance requirements, while also providing an engaging experience for administrators and employees. With the foundation of automation and engagement, we also provide clients with valuable insights to their HR data.

Payroll

Our Payroll module enables clients to automate key payroll processes and manage compliance in an environment of continued regulatory complexity. Key features of the Payroll module include:

Feature	Functionality
Payroll Entry	<input type="checkbox"/> Configurable payroll entry grid allowing easy entry and update of critical Payroll data <input type="checkbox"/> Real-time updates to open pay cycles <input type="checkbox"/> Support for garnishments, child support, union and other specialized calculations
Employee Tax Management	<input type="checkbox"/> Setup, configuration and calculation of all local, state and federal taxes <input type="checkbox"/> Tax validation using geolocation services to ensure accurate tax setup <input type="checkbox"/> Tax filing services

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Proration and Retro	<ul style="list-style-type: none"> <input type="checkbox"/> Automated identification of scenario changes to employee data that impact pay for the pay cycle <input type="checkbox"/> Recommended calculations for mid-pay period hires for hourly and salary employees <input type="checkbox"/> Recommended calculations for backdated changes of pay rates
Advanced Reporting	<ul style="list-style-type: none"> <input type="checkbox"/> Easy-to-use, powerful reporting dashboard enables users to design and create ad-hoc reports or rely on over 100 standard reports <input type="checkbox"/> Ability to generate a variety of pre-process reports via report library and report writer <input type="checkbox"/> Real-time report generation, including the ability to automatically schedule reports to run on a user-defined frequency <input type="checkbox"/> Point-in-time reporting, including comparative analysis over multiple periods, allowing users to view data from any time in history
Data Integration	<ul style="list-style-type: none"> <input type="checkbox"/> Ability to set up multiple data integrations with a wide array of benefits and retirement plan providers

Core HR

Paylocity’s Core HR module provides a set of HR capabilities enabling clients to manage HR data in an effective and timely manner while positively impacting employee engagement and culture. Key features of Core HR include:

Feature	Functionality
Employee Record Management	<ul style="list-style-type: none"> <input type="checkbox"/> Manages payroll deductions for employee benefit plans such as health and 401(k) <input type="checkbox"/> Automated employee time-off requests <input type="checkbox"/> Tracks employee skills, events, education and prior employment <input type="checkbox"/> Stores employee documentation electronically <input type="checkbox"/> Records and tracks company property issued to employees <input type="checkbox"/> Ability to add custom fields to track additional employee related information
Configurable Templates	<ul style="list-style-type: none"> <input type="checkbox"/> Combination of standard and modifiable templates powered by highly-flexible drag-and-drop technology <input type="checkbox"/> Includes standard templates to accommodate changes for new hires, job changes, leave of absences and terminations <input type="checkbox"/> Enables users to configure user interface to efficiently align to organizations’ business processes <input type="checkbox"/> Ability to require additional data, add default values and insert new custom fields increases accuracy and consistency of data across the platform
Custom Checklists	<ul style="list-style-type: none"> <input type="checkbox"/> Allows users to track critical steps in hiring and other processes <input type="checkbox"/> Triggers reports and notification emails to track critical steps and informs users when tasks are complete
HR Compliance	<ul style="list-style-type: none"> <input type="checkbox"/> Manage ACA compliance activities <input type="checkbox"/> Family Medical Leave Act (FMLA) tracking <input type="checkbox"/> Facilitate Equal Employment Opportunity (EEO) assessment and filing <input type="checkbox"/> Occupational Safety & Health Administration (OSHA) tracking <input type="checkbox"/> Workers’ compensation tracking and reporting <input type="checkbox"/> I-9 verification <input type="checkbox"/> Provides a year end dashboard to manage IRS deadlines
HR Insight and Analytics	<ul style="list-style-type: none"> <input type="checkbox"/> Provides a dashboard view into critical HR metrics such as headcount, employee turnover and potential at-risk employees <input type="checkbox"/> Users can choose between different types of graphical display or export the information to spreadsheets or other documents

- Retention dashboard assists employers in identifying and taking action on at-risk employees to improve employee retention
- Compliance and reporting
- Full online and mobile access through virtually any device having Internet access to payroll, HR and benefits information
- Provides the ability for administrators to communicate company news and policy changes, such as handbook revisions, and to post documents and create custom web pages to communicate with employees
- Provides a single view for managers where they can approve employee changes and requests, manage outstanding tasks and easily access employee information
- Improves communication among managers and HR and payroll and finance departments

Talent

Paylocity’s Talent modules are designed to bring ease and convenience to processes that attract and retain talent within an organization. The modules provide an engaging employee experience and enable clients to manage their talent throughout their employees’ tenures, starting at recruiting and carrying through onboarding, learning and performance management. Key features of our Talent module include:

Feature	Functionality
Reviews	<ul style="list-style-type: none"> <input type="checkbox"/> Provides the ability for employees and managers to complete online reviews, add comments and sign off on completed reviews <input type="checkbox"/> Includes automated workflow at each step of the review process with ability for HR administrators to review and provide feedback prior to final approval
360° Feedback	<ul style="list-style-type: none"> <input type="checkbox"/> Provides the ability to access feedback from employees across the organization to receive input on employee performance and accomplishments <input type="checkbox"/> Enables year-round or point-in-time 360° feedback
Goals Management	<ul style="list-style-type: none"> <input type="checkbox"/> Manages employee goals and appraisals in a single place to reduce the time required to navigate between screens <input type="checkbox"/> Allows specific goals to be displayed on the performance review for increased employee focus and development <input type="checkbox"/> Assigns goals specific to employees based on skill level and other factors
Impressions	<ul style="list-style-type: none"> <input type="checkbox"/> Provides employees the ability to recognize each other and provide immediate feedback <input type="checkbox"/> Impression leaderboard is visible to everyone in the organization providing recognition for top performers
Recruiting	<ul style="list-style-type: none"> <input type="checkbox"/> Auto-fills resume information to save time and effort in the candidate’s application process <input type="checkbox"/> Serves as a repository of applicant information and feedback for future reference and sourcing <input type="checkbox"/> Tracks applicants through the lifecycle of the recruiting process, reducing time spent on the recruiting and talent acquisition process and so that users quickly know the status of any prospects at critical stages in the process <input type="checkbox"/> Integration to allow posting to over 20,000 job boards to reach a broad range of applicants <input type="checkbox"/> Manage the full employment offer process including automated creation of offer letters and background check completion <input type="checkbox"/> Seamless transition of an employee from recruiting to the Onboarding process

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- Onboarding
 - Features a mobile-responsive design and attractive, intuitive interface, engaging new hires in the process
 - Provides robust event management capabilities, empowering administrators to proactively manage the onboarding process
 - Highly configurable, allowing administrators to tailor tasks and overall experience for new hires
 - Includes a withholding forms wizard, simplifying the process of completing important tax-related paperwork, including local W-4 forms
 - Permits the ability to add customized content including welcome message, documents, videos and other company specific information
 - Automates the necessary employment eligibility processes including collection of I-9s and integration with E-Verify
- Journals
 - Captures and tracks ongoing discussions with employees to support performance appraisals
- Compensation Management
 - Enables compensation professionals to configure tailored compensation plans and create automated approval workflows based on organizational pay cycles
 - Creates visibility to an executive-level view of organizational and team budgets and payment allocations
 - Offers managers the ability to manage their budgets and distribute compensation increases by drilling down into employee performance, pay history and more
 - Ability to manage bonus payouts as well as pay increases
- Surveys
 - Facilitates the collection and summarization of all survey needs
 - Default library of surveys for common tasks like new hire surveys, pulse surveys and organizational health surveys
 - Summarizes survey information using analysis to enable clients to gauge respondent sentiment
 - Ability to send confidential surveys
 - Ability to generate a general survey link that can be distributed without assignment to employees
- Learning Management System
 - Provides a cost-effective way to share, assess and track employee knowledge
 - Enables clients to create their own content using built-in video recording technology for easy content creation and disbursement
 - Ability to assign training courses to employees and manage training assignments through completion with due dates, reminders and reporting
 - Support for multiple content types, including documents, recorded or uploaded videos and SCORM content

Workforce Management

Paylocity’s Workforce Management modules include time and attendance and scheduling functionality, enabling clients to effectively collect hourly data for employees, improve productivity and help organizations control labor costs. Additionally, expense management functionality streamlines and automates expense management processes by eliminating manual steps involved in filing, approving, and reimbursing expenses. Key features within the Workforce Management modules include:

Feature	Functionality
Time Collection	<input type="checkbox"/> Time and attendance tracking, including overtime, rounding rules, payroll policies and labor allocation <input type="checkbox"/> Tracks tardiness, absenteeism, and misuse of break or meal periods <input type="checkbox"/> Compliance tools to ensure clients have visibility to meal premium and overtime requirements <input type="checkbox"/> Ability to collect time through punching or time recording <input type="checkbox"/> Support for multiple hardware options including traditional time clocks, biometric devices and integrated kiosk terminals
Schedule Management	<input type="checkbox"/> Ability to create and publish employee schedules <input type="checkbox"/> Enforcement of punching based on schedules <input type="checkbox"/> Ability to manage schedules based on budgeted dollars or total hours <input type="checkbox"/> Mobile schedule views to allow employees easy access to their schedules and submit time-off requests via the mobile app
Manager Tools	<input type="checkbox"/> Alerts for missing punches <input type="checkbox"/> Dashboard to enable supervisors to effectively manage their workforces <input type="checkbox"/> Ability to approve time cards and time-off requests via the mobile app
Geo-fencing Mobile Restriction	<input type="checkbox"/> Ability for employees to punch in and out from their mobile devices <input type="checkbox"/> Geo-fencing capabilities that allow managers to set parameters for where punches may occur <input type="checkbox"/> Ability to specify the geo-fencing parameters at the individual or group level <input type="checkbox"/> Flexibility to specify an unlimited number of geo-fenced areas to accommodate a mobile workforce
Simplified Expense Management Workflow	<input type="checkbox"/> File and submit expenses in an intuitive and unified module <input type="checkbox"/> Capture and submit receipts from a mobile device <input type="checkbox"/> Approve expense reports quickly and easily <input type="checkbox"/> Receive notifications throughout the entire reimbursement process
Integrated Payments for Expense Reimbursements	<input type="checkbox"/> Flexibility to process payment as part of the normal payroll cycle or on a separate payment guideline <input type="checkbox"/> Payment utilizes employees’ existing payment choices (direct deposit or check) <input type="checkbox"/> Automatically creates general ledger entries to expedite the recording of employee expenses
Configurable Expense Policies	<input type="checkbox"/> Ability to specify approval workflow based on data elements related to specific employees <input type="checkbox"/> Enforcement of reimbursement limits, notes and additional information requirements <input type="checkbox"/> Allows proxy submitters to enable administrative support for employees when necessary <input type="checkbox"/> Generate and analyze spend reports

Benefits

Paylocity’s Benefits modules provide benefit management solutions that integrate with insurance carrier systems to provide automated administrative processes allowing users to choose benefit elections and make life event changes online, summarize benefit elections and perform other similar benefit-related tasks. These modules support advanced functionality such as premium reconciliation, management of voluntary benefits and advanced reporting, while seamlessly integrating with Paylocity’s Payroll solution to provide for a fully-automated benefit experience. Key features of Benefits include:

Feature	Functionality
Employee Enrollment	<ul style="list-style-type: none"><input type="checkbox"/> Easy to follow and customizable enrollment process for employees<input type="checkbox"/> Support for annual enrollment as well as the ability to manage changes to benefits due to life events<input type="checkbox"/> Easy access to view benefit elections<input type="checkbox"/> Allows modeling of payroll deductions and changes for life events to enable employees to make educated benefit decisions
Administrative Efficiency	<ul style="list-style-type: none"><input type="checkbox"/> Customizable enrollment portal content (text, links, documents, logos)<input type="checkbox"/> Can develop enrollment reminders through announcements, enrollment rules, and eligibility groups<input type="checkbox"/> Reporting on employee enrollment status and enrollment summary<input type="checkbox"/> Electronic Data Interchange (EDI) support for insurance carriers

Third-Party Administrative (TPA) Solutions

Paylocity’s TPA solutions are designed to modernize the administration of Health Savings Account (HSA), Flexible Spending Account (FSA), Health Reimbursement Arrangement (HRA), Transportation Management Account (TMA) and Premium Only Plan (POP) benefits by providing users with a single, unified access point for payroll, HR, and benefits administration. Our TPA solutions includes mobile and web access, allowing users to see transaction details and account balances, while having the ability to submit claims from our integrated employee portal. It also eases the administration of Consolidated Omnibus Budget Reconciliation Act (COBRA) coverage and retiree billing.

Implementation and Client Services

We supplement our comprehensive software platform with an integrated implementation and client service organization with deep subject matter expertise. Delivering clients a positive experience and a high level of support is an essential element of our ability to sell our solutions and retain clients.

Implementation and Training Services

Our clients today are primarily medium-sized organizations that are typically migrating to our platform from a competitive solution or are adopting their first online payroll and HCM solution. These organizations often have limited internal resources and rely on us to implement their payroll and HCM solutions. We typically implement our product suite within only three to six weeks. Each client is guided through the implementation process by our knowledgeable consultants for all implementation matters. We believe our ability to rapidly implement our solutions is principally due to the combination of our emphasis on engagement with the client, our standardized methodology, our cloud-based architecture and our highly-configurable, easy-to-use products.

We offer clients the opportunity to utilize on-demand or in-class training designed to provide clients with general knowledge on our solutions. We also host an annual client conference for clients to learn about new products and features and allow clients to provide feedback and learn best practices.

Client Service

Our client service model is designed to serve and support the needs of our clients and to build loyalty by developing strong relationships with clients. We strive to achieve high revenue retention, in part, by delivering high-quality service. Our revenue retention was greater than 92% in each of fiscal 2017, 2018 and 2019. Each client is assigned an account management team that serves as the central point of contact for any questions or support needs. We believe this approach enhances client service by providing clients with knowledgeable resources who understand the client's business, respond quickly, and are accountable for the overall client experience. Account managers are supplemented by teams with deep technical and subject matter expertise who help to expediently and effectively address client needs. We also proactively solicit client feedback through ongoing surveys from which we receive actionable feedback that we use to enhance our client service processes. We have also built an online knowledge repository for clients that provide industry content and Paylocity product and service information.

Tax and Regulatory Services

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

Clients

Excluding clients acquired as part of the BeneFLEX acquisition, as of June 30, 2019, we provided our payroll and HCM software solutions to approximately 20,200 clients, all located in the U.S. The rate at which we add clients is variable period-to-period and is also seasonal as many clients switch solutions during the first calendar quarter of each year. Clients include for-profit and non-profit organizations across industries including business services, financial services, healthcare, manufacturing, restaurants, retail, technology and others. For each of the three years ended June 30, 2017, 2018 and 2019, no client accounted for more than 1% of our revenues.

Sales and Marketing

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

The sales cycle begins with a sales lead generated by the sales representative, through our third-party referral network, a client referral, our telemarketing team, our external website, e-mail marketing, or other territory-based activities. We support our sales force with a marketing program that includes seminars and webinars, email marketing, social media marketing, broker events and web marketing.

Referral Network

As a core element of our business strategy, we have developed a referral network of third-party service providers, including 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants, that recommend our solutions and provide referrals. Our referral network has become an increasingly important component of our sales process, and in fiscal 2019, more than 25% of our new client revenue originated by referrals from participants in our referral network.

We believe participants in our referral network refer potential clients to us because of the strength of our products and services, the value we provide our referral partners through our broker portal, the fact that we do not provide services that compete with our referral networks, and because we offer third parties the ability to integrate their systems with our platform. Unlike other payroll and HCM solution providers who also provide retirement plans, health insurance and other products and services competitive with the offerings of the participants in our referral network, we

focus only on our core business of providing payroll and HCM solutions. In some cases, we have formalized relationships in which we are a recommended vendor of these participants. In other cases, relationships are informal. We typically do not compensate these participants for referrals.

Partner Ecosystem

We have developed a partner ecosystem of third-party systems, such as 401(k), benefits and insurance provider systems, with whom we provide automated data integration for their clients. These third-party providers require certain financial, payroll and other employee demographic information from their clients in order to efficiently provide their respective services. After securing authorization from the client, we exchange data with these providers. In turn, these third-party providers supply data to us, which allows us to deliver comprehensive HR and benefit management services to our clients. We believe our partnerships with these third parties are an important part of their service offerings. We have also developed our solutions to integrate with a variety of other systems used by our clients, such as accounting, point of sale, banking, expense management, recruiting, background screening and skills assessment solutions.

Paylocity's automated data integration reduces the complexity and risk of error of manual data transfers and saves clients and employees time. Direct and automated data transmission improves the accuracy of data and facilitates data collection in partners' systems. Having automated data integration with a payroll and HCM provider differentiates partners' product offerings, strengthening their competitive positioning in their own markets.

Technology

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

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

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

Competition

The market for payroll and HCM solutions is both fragmented and highly competitive. Our competitors vary for each of our solutions and primarily include payroll and HR service and software providers, such as Automatic Data Processing, Inc., Paychex, Inc., Paycom Software, Inc., Paycor, Inc., Ultimate Software Group, Inc. and other local and regional providers.

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

- Focus on medium-sized organizations;
- Breadth and depth of product functionality;
- Configurability and ease of use of our solutions;
- Modern, intuitive user experience;
- Benefits of a cloud-based technology platform;
- Ability to innovate and respond to client needs rapidly;
- Domain expertise in payroll and HCM;
- Quality of implementation and client service;
- Ease of implementation;
- Real-time web-based payroll processing; and
- Access to a wide variety of complementary third-party service providers.

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

Research and Development

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

Research and development costs, including research and development costs that were capitalized, were \$44.5 million, \$55.7 million and \$73.6 million for the years ended June 30, 2017, 2018 and 2019, respectively. Our research and development personnel are principally located at our headquarters, although we seek to hire highly experienced personnel wherever they are located.

Intellectual Property

Our success is dependent, in part, on our ability to protect our proprietary technology and other intellectual property rights. We rely on a combination of trade secrets, copyrights and trademarks, as well as contractual protections to establish and protect our intellectual property rights. We require our employees, consultants and other third parties to enter into confidentiality and proprietary rights agreements and control access to software, documentation and other proprietary information. Although we rely on laws respecting intellectual property rights, including trade secret, copyright and trademark laws, as well as contractual protections to establish and protect our intellectual property rights, we believe that factors such as the technological and creative skills of our personnel, creation of new modules, features and functionality and frequent enhancements to our modules are more essential to establishing and maintaining our technology leadership position.

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

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

Employees

As of June 30, 2019, we had approximately 3,050 full-time employees. None of our employees are represented by a union or are a party to a collective bargaining agreement, and we have not experienced any work stoppages. We believe we have good relations with our employees and that our employee-focused culture benefits our clients and supports our growth. Our management team has remained committed to maintaining and improving our culture even as we grow rapidly, which is evidenced by our consistent receipt of top rankings from our employees as a great place to work in all of our office locations.

Available Information

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

Item 1A. Risk Factors.

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

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

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

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

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

- The extent to which our products achieve or maintain market acceptance;
- Our ability to introduce new products and enhancements and updates to our existing products on a timely basis;
- Competitive pressures and the introduction of enhanced products and services from competitors;
- Changes in client budgets and procurement policies;
- The amount and timing of our investment in research and development activities and whether such investments are capitalized or expensed as incurred;
- The number of our clients' employees;
- Timing of recognition of revenues and expenses;
- Client renewal rates;
- Seasonality in our business;
- Technical difficulties with our products or interruptions in our services;
- Our ability to hire and retain qualified personnel;
- A repeal of or changes to the laws and regulations related to the products and services which we offer;
- Changes in accounting principles; and
- Unforeseen legal expenses, including litigation and settlement costs.

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

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

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

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

We have been rapidly growing our revenue and number of clients, and we will seek to do the same for the foreseeable future. However, the growth in our number of clients puts significant strain on our business, requires significant capital expenditures and increases our operating expenses. To manage this growth effectively, we must attract, train, and retain a significant number of qualified sales, implementation, client service, software development, information technology and management personnel. We also must maintain and enhance our technology infrastructure and our financial and accounting systems and controls. If we fail to effectively manage our growth or we over-invest or under-invest in our business, our business and results of operations could suffer from the resultant weaknesses in our infrastructure, systems or controls. We could also suffer operational mistakes, a loss of business opportunities and employee losses. If our management is unable to effectively manage our growth, our expenses might increase more than expected, our revenue could decline or might grow more slowly than expected, and we might be unable to implement our business strategy. In addition, our revenue growth rates may decline in future periods as a result of various factors, including our failure to manage our growth effectively, our increased market penetration and the maturation of our business, slowing demand for our services, and a decrease in the growth of the overall market, among others.

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

The market for payroll and HCM solutions is fragmented, highly competitive and rapidly changing. Our competitors vary for each of our solutions and primarily include payroll and HR service and software providers, such as Automatic Data Processing, Inc., Paychex, Inc., Paycom Software, Inc., Paycor, Inc., Ultimate Software Group, Inc. and other local and regional providers.

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

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

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

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

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

changes, or if we are unable to modify our products and services on a timely basis or to effectively bring new products to market, our sales may suffer.

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

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

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

Our solutions are affected by changes in tax, benefit and other laws and regulations and generally must be updated regularly to maintain their accuracy and competitiveness. Although we believe our SaaS platform provides us with flexibility to release updates in response to these changes, we cannot be certain that we will be able to make the necessary changes to our solutions and release updates on a timely basis, or at all. Failure to do so could have an adverse effect on the functionality and market acceptance of our solutions. Changes in tax, benefit and other laws and regulations could require us to make significant modifications to our products or delay or cease sales of certain products, which could result in reduced revenues or revenue growth and our incurring substantial expenses and write-offs.

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

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

In addition, our ability to deliver our cloud-based modules depends on the development and maintenance of Internet infrastructure by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity, bandwidth capacity, and security. Our services are designed to operate without interruption. However, we have experienced and expect that we will experience future interruptions and delays in services and availability from time to time. In the event of a catastrophic event with respect to one or more of our systems, we may

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experience an extended period of system unavailability, which could negatively impact our relationship with clients. To operate without interruption, both we and our clients must guard against:

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

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

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

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

In addition, while we own, control and have access to our servers and all of the components of our network that are located in our backup data centers, we do not control the operation of these facilities. The operators of our third party data center facilities have no 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 the data center operators are acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur costs and experience service interruption in doing so.

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

Our solutions involve the storage and transmission of our clients' and their employees' proprietary and confidential information. This information includes bank account numbers, tax return information, social security numbers, benefit information, retirement account information, payroll information, system passwords, and in the case of our benefit administration solution, BeneFLEX, health information protected by the Health Insurance Portability and

Accountability Act of 1996, as amended, or HIPAA. In addition, we collect and maintain personal information on our own employees in the ordinary course of our business. Finally, our business involves the storage and transmission of funds from the accounts of our clients to their employees, taxing and regulatory authorities and others. As a result, unauthorized access or security breaches of our systems or the systems of our clients could result in the unauthorized disclosure of confidential information, theft, litigation, indemnity obligations and other significant liabilities. Because the techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are employed, we may be unable to anticipate these techniques or to implement adequate preventative measures in advance. As cyber threats continue to evolve, we are focused on ensuring that our operating environments safeguard and protect personal and business information. We may be required to invest significant additional resources to comply with evolving cybersecurity regulations and to modify and enhance our information security and controls, and to investigate and remediate any security vulnerabilities. While we have security measures and controls in place to protect confidential information, prevent data loss, theft and other security breaches, including penetration tests of our systems by independent third parties, if our security measures are breached, our business could be substantially harmed and we could incur significant liabilities. The costs of investigating, mitigating, and reporting such a breach to affected individuals (if required) can be substantial. In addition, if a high-profile security breach occurs with respect to an industry peer, our clients and potential clients may generally lose trust in the security of payroll and HCM modules. Any such breach or unauthorized access could negatively affect our ability to attract new clients, cause existing clients to terminate their agreements with us, result in reputational damage and subject us to lawsuits, regulatory fines (including, in the case of our benefit administration solution, BeneFLEX, penalties for failure to comply with HIPAA) or other actions or liabilities which could materially and adversely affect our business and operating results.

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

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

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

We recognize our expenses over varying periods based on the nature of the expense. When a client terminates its relationship with us, we may not have derived enough revenue from that client to cover associated implementation costs. Our expenses fluctuate as a percentage of revenue, and changes in our business generally may not be immediately reflected in our results of operations.

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

We primarily sell our products and implementation services through our direct sales force. To grow our business, we intend to focus on growing our client base for the foreseeable future. Our ability to add clients and to achieve revenue growth in the future will depend upon our ability to grow and develop our direct sales force and on their ability to productively sell our solutions. Identifying and recruiting qualified personnel and training them in the use of our software requires significant time, expense and attention. The amount of time it takes for our sales representatives to be fully-trained and to become productive varies widely. In addition, if we hire sales representatives from competitors or

other companies, their former employers may attempt to assert that these employees have breached their legal obligations, resulting in a diversion of our time and resources.

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

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

Referrals from third-party service providers, including 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants, represent a significant source of potential clients for our products and implementation services. For example, we estimate that more than 25% of our new sales in fiscal 2019 were referred to us from our referral network participants. In most cases, our relationships with referral network participants are informal, although in some cases, we have formalized relationships where we are a recommended vendor for their clients.

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

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

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

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

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

Our payroll processing business involves the movement of significant funds from the account of a client to employees and relevant taxing authorities. For example, in fiscal 2019 we processed over \$134 billion in payroll transactions. Though we debit a client's account prior to any disbursement on its behalf, due to Automated Clearing House, or ACH, banking regulations, funds previously credited could be reversed under certain circumstances and timeframes after our payment of amounts due to employees and taxing and other regulatory authorities. There is therefore a risk that the employer's funds will be insufficient to cover the amounts we have already paid on its behalf. While such shortage and accompanying financial exposure has only occurred in very limited instances in the past, should clients default on their payment obligations in the future, we might be required to advance substantial amounts of funds to cover such obligations. In such an event, we may be required to seek additional sources of short-term liquidity, which may not be available on reasonable terms, if at all, and our operating results and our liquidity could be adversely affected and our banking relationships could be harmed.

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

Our recurring revenues are based in part on the number of our clients' employees. As a result, we are subject to risks arising from adverse changes in economic and political conditions. The state of the economy and the rate of employment, which deteriorated in the recent broad recession, may deteriorate again in the future. If the current economic climate begins to decline, many clients may reduce their number of employees and delay or reduce technology purchases. This could also result in reductions in our revenues and sales of our products, longer sales cycles, increased price competition and clients' purchasing fewer solutions than they have in the past. Any of these events would likely harm our business, results of operations, financial condition and cash flows from operations.

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

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

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

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

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

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

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

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

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

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

Additionally, we expect that existing laws, regulations, and standards may be interpreted in new and differing manners in the future, and may be inconsistent among jurisdictions. Future laws, regulations, standards, and other obligations, and changes in the interpretation of existing laws, regulations, standards, and other obligations could result in increased regulation, increased costs of compliance and penalties for non-compliance, and limitations on data collection, use, disclosure, and transfer for Paylocity and our clients. For example, in 2016, the European Union ("EU") and United States agreed to a framework for data transferred from the EU to the United States, called the Privacy Shield,

but this new framework has been challenged by private parties and may face additional challenges by national regulators or additional private parties. Additionally, in 2016 the EU adopted a new regulation governing data privacy called the General Data Protection Regulation (“GDPR”), which became effective in May 2018. The GDPR establishes new requirements applicable to the handling of personal data and imposes penalties for non-compliance of up to 4% of worldwide revenue. California also recently enacted legislation, the California Consumer Privacy Act of 2018, that will afford consumers expanded privacy protections when it goes into effect on January 1, 2020. Legislators have stated that they intend to propose amendments to this legislation, and it remains unclear what, if any, modifications will be made to this legislation or how it will be interpreted. All of these legislative and regulatory initiatives may adversely affect our clients’ ability to process, handle, store, use and transmit demographic and personal information regarding their employees and family members, which could reduce demand for our solutions.

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

If third parties we work with violate applicable laws or regulations or our policies, such violations may also put our clients’ content at risk and could in turn have an adverse effect on our business. Any significant change to applicable laws, regulations, or industry practices regarding the collection, use, retention, security, or disclosure of our clients’ content, or regarding the manner in which the express or implied consent of clients for the collection, use, retention, or disclosure of such content is obtained, could increase our costs and require us to modify our services and features, possibly in a material manner, which we may be unable to complete, and may limit our ability to store and transmit client data or develop new services and features.

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

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

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

In addition, we may be unable to respond quickly enough to accommodate increased client demand for implementation and client services driven by our growth. In order to ensure that we have sufficient employees to implement and service our solutions, we must closely coordinate hiring of personnel with our projected sales for a particular period. Because our sales cycle is typically only three to six weeks long, we may not be successful in coordinating hiring of implementation and client service personnel to meet increased demand for our services. Increased

demand for services without a corresponding staffing increase of qualified personnel could adversely affect the quality of services provided to our clients, and our business and our reputation could be harmed.

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

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

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

Defects and errors and any failure by us to identify and address them could result in delays in product introductions and updates, loss of revenue or market share, liability to clients or others, failure to achieve market acceptance or expansion, diversion of development and other resources, injury to our reputation, and increased service and maintenance costs. Defects or errors in our product or service processes might discourage existing or potential clients from purchasing from us. Correction of defects or errors could prove to be impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability might be substantial and could adversely affect our operating results.

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

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

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

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

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

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

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

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

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

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

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

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

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

operating results and leading analysts or potential investors to lower their expectations of our performance, which could reduce the trading price of our stock.

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

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

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

In order to protect our intellectual property rights, we may be required to spend significant resources, including cybersecurity resources, to monitor and protect these rights. Our intellectual property could be wrongfully acquired as a result of a cyberattack or other wrongful conduct by employees or third parties. Litigation may be necessary in the future to enforce our intellectual property rights and to protect our trade secrets. Litigation brought to protect and enforce our intellectual property rights could be costly, time consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. Our inability to protect our proprietary technology against unauthorized copying or use, as well as any costly litigation or diversion of our management's attention and resources, could delay further sales or the implementation of our solutions, impair the functionality of our solutions, delay introductions of new solutions, result in our substituting inferior or more costly technologies into our solutions, or injure our reputation. In addition, we may be required to license additional technology from third parties to develop and market new solutions, and we cannot assure you that we could license that technology on commercially reasonable terms, or at all. Although we do not expect that our inability to license this technology in the future would have a material adverse effect on our business or operating results, our inability to license this technology could adversely affect our ability to compete.

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

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

payments, in connection with any such claim or litigation and to obtain licenses, modify applications, or refund fees, which could be costly. Even if we were to prevail in such a dispute, any litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and key personnel from our business operations.

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

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

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

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

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

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

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

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

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related commerce or communications generally, resulting in reductions in the demand for Internet-based applications such as ours.

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

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

Changes in regulatory laws or requirements applicable to our software and services could impose increased costs on us, delay or prevent our introduction of new products and services, and impair the function or value of our existing products and services.

Our products and services may become subject to increasing regulatory requirements, and as these requirements proliferate, we may be required to change or adapt our products and services to comply. Changing regulatory requirements might render our products and services obsolete or might block us from developing new products and services. This might in turn impose additional costs upon us to comply or to further develop our products and services. It might also make introduction of new products and services more costly or more time-consuming than we currently anticipate. It might even prevent introduction by us of new products or services or cause the continuation of our existing products or services to become more costly. For example, the adoption of new money transmitter or money services business statutes in jurisdictions or changes in regulators’ interpretation of existing state and federal money transmitter or money services business statutes or regulations, could subject us to registration or licensing or limit business activities until we are appropriately licensed. These occurrences could also require changes to the manner in which we conduct some aspects of our business or invest client funds, which could adversely impact interest income from investing client funds. Should any state or federal regulators make a determination that we have operated as an unlicensed money services business or money transmitter, we could be subject to civil and criminal fines, penalties, costs, legal fees, reputational damage or other negative consequences. In addition, if the Affordable Care Act, or ACA, is repealed or modified in whole or in part, or if implementation of certain aspects of the ACA is delayed, such repeal, modification or delay could adversely impact the revenue we currently generate from our ACA Compliance solution as well as overall gross margins. Any of these regulatory implementations or changes could have an adverse effect on our business, operating results or financial condition.

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

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

If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing or ACH facility secured by us in the future could involve restrictive covenants relating to our capital-raising activities and other financial and operational

matters, which might make it more difficult for us to obtain additional capital and to pursue business opportunities and to grow our business. In addition, we might not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

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

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

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

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

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

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

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

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

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

- Inability to integrate or benefit from acquired technologies or services in a profitable manner;
- Unanticipated costs or liabilities associated with the acquisition;

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

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

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

Risks Related to Ownership of Our Common Stock

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

As of August 2, 2019, our directors, executive officers and holders of more than 5% of our common stock, together with their respective affiliates, beneficially owned, in the aggregate, approximately 36.3% of our outstanding common stock. This significant concentration of ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders. In addition, these stockholders will be able to exercise influence over all matters requiring stockholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit the ability of our other stockholders to influence corporate matters and may have the effect of delaying or preventing a change in control, including a merger, consolidation, or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if that change in control would benefit our other stockholders.

Our stock price may be subject to wide fluctuations.

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

- Our operating performance and the operating performance of similar companies;

- Announcements by us or our competitors of acquisitions, business plans or commercial relationships;
- Any major change in our board of directors or senior management;
- Publication of research reports or news stories about us, our competitors, or our industry, or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- The public's reaction to our press releases, our other public announcements and our filings with the SEC;
- Sales of our common stock by our directors, executive officers and affiliates;
- Adverse market reaction to any indebtedness we may incur or securities we may issue in the future;
- Short sales, hedging and other derivative transactions in our common stock;
- Threatened or actual litigation;
- Other events or factors, including changes in general conditions in the United States and global economies or financial markets (including acts of God, war, incidents of terrorism, or other destabilizing events and the resulting responses to them).

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

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

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

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

As of August 2, 2019, we had an aggregate of 53,082,006 outstanding shares of common stock. The 17,362,750 shares sold in our initial public offering, follow-on offering and secondary offering can be freely sold in the public market without restriction. The remaining shares can be freely sold in the public market, subject in some cases to volume and other restrictions under Rule 144 and 701 under the Securities Act of 1933, as amended, and various agreements.

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

shares are sold, or if it is perceived that they will be sold, in the public market, the trading price of our common stock could decline.

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

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

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

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

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

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

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of June 30, 2019, our corporate headquarters occupied approximately 316,000 square feet in Schaumburg, Illinois under leases with final expiration in October 2032. We also utilize office spaces consisting of approximately 72,000 square feet in Lake Mary, Florida and approximately 39,000 square feet in Meridian, Idaho as other major operations centers. We lease other smaller facilities across the U.S. that serve as data centers, sales offices and distribution centers.

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

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

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

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

	High	Low
Year ended June 30, 2018		
First Quarter	\$ 49.49	\$ 42.54
Second Quarter	\$ 53.96	\$ 44.11
Third Quarter	\$ 57.16	\$ 41.15
Fourth Quarter	\$ 64.21	\$ 47.29
Year ended June 30, 2019		
First Quarter	\$ 88.47	\$ 56.78
Second Quarter	\$ 81.30	\$ 53.46
Third Quarter	\$ 92.50	\$ 56.70
Fourth Quarter	\$ 103.80	\$ 82.81

On August 2, 2019, the last reported sale price of our common stock on the NASDAQ Global Select Market was \$99.68 per share, and there were 15 holders of record of our common stock. The actual number of holders of common stock is greater than these numbers of record holders and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and nominees. The number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

Use of Proceeds from Initial Public Offering of Common Stock

On March 24, 2014, we completed our initial public offering, or IPO, of 8,101,750 shares of common stock, at a price of \$17.00 per share, before underwriting discounts and commissions. We sold 5,366,667 of such shares and existing shareholders sold an aggregate of 2,735,083 of such shares. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-193661), which was declared effective by the SEC on March 18, 2014.

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

Use of Proceeds from Follow-On Offering of Common Stock

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

Use of Proceeds from Secondary Offering of Common Stock

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

Dividend Policy

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

Equity Compensation Plan Information

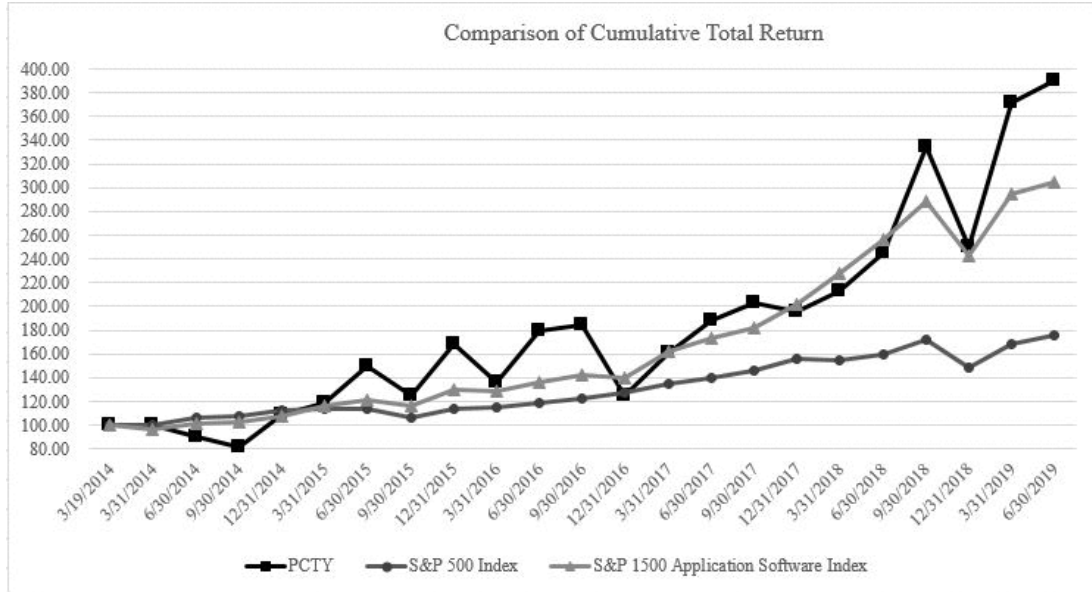
Information regarding the securities authorized for issuance under our equity compensation plans will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

Performance Graph

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

The following graph compares the total cumulative stockholder return on our common stock with the total cumulative return of the S&P 500 Index and the S&P 1500 Application Software Index during the period commencing on March 19, 2014, the initial trading day of our common stock, and ending on June 30, 2019. The graph assumes that \$100 was invested at the beginning of the period in our common stock and in each of the comparative indices, and the

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



Item 6. Selected Financial Data.

Consolidated Selected Financial Data

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

	Year Ended June 30,				
	2015	2016	2017	2018	2019
(in thousands, except per share data)					
Consolidated Statements of Operations Data:					
Revenues:					
Recurring fees	\$ 142,168	\$ 217,416	\$ 284,817	\$ 354,432	\$ 436,955
Interest income on funds held for clients	1,901	2,688	3,631	9,093	19,881
Total recurring revenues	144,069	220,104	288,448	363,525	456,836
Implementation services and other	8,629	10,597	11,562	14,002	10,797
Total revenues	152,698	230,701	300,010	377,527	467,633
Cost of revenues:					
Recurring revenues	46,366	66,131	85,399	104,009	125,211
Implementation services and other	24,530	31,954	38,588	45,188	28,640
Total cost of revenues	70,896	98,085	123,987	149,197	153,851
Gross profit	81,802	132,616	176,023	228,330	313,782
Operating expenses:					
Sales and marketing	43,035	61,832	77,506	95,484	112,599
Research and development	19,864	26,736	29,098	37,645	50,329
General and administrative	32,824	47,598	62,123	79,252	94,630
Total operating expenses	95,723	136,166	168,727	212,381	257,558
Operating income (loss)	(13,921)	(3,550)	7,296	15,949	56,224
Other income (expense)					
Income (loss) before income taxes	(13,867)	(3,674)	7,369	16,751	58,046
Income tax expense (benefit)	105	177	651	(21,847)	4,223
Net income (loss)	\$ (13,972)	\$ (3,851)	\$ 6,718	\$ 38,598	\$ 53,823
Net income (loss) per share:					
Basic	\$ (0.28)	\$ (0.08)	\$ 0.13	\$ 0.74	\$ 1.02
Diluted	\$ (0.28)	\$ (0.08)	\$ 0.12	\$ 0.70	\$ 0.97
Weighted average shares used in computing net income (loss) per share:					
Basic	50,127	50,913	51,415	52,425	52,914
Diluted	50,127	50,913	54,057	54,887	55,414
Other Financial Data:					
Adjusted Gross Profit(1)	\$ 87,226	\$ 141,029	\$ 189,272	\$ 247,193	\$ 336,247
Adjusted Recurring Gross Profit(1)	\$ 101,876	\$ 161,184	\$ 214,825	\$ 276,857	\$ 352,225
Adjusted EBITDA(1)	\$ 8,238	\$ 28,398	\$ 56,190	\$ 81,297	\$ 134,047

	As of June 30,				
	2015	2016	2017	2018	2019
(in thousands)					
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 81,258	\$ 86,496	\$ 103,468	\$ 137,193	\$ 132,476
Corporate investments	—	—	—	732	29,314
Working capital(2)	69,296	68,986	88,040	107,395	140,141
Funds held for clients	591,219	1,239,622	942,459	1,225,614	1,394,469
Total assets	720,548	1,390,689	1,137,441	1,507,599	1,803,941
Client fund obligations	591,219	1,239,622	942,459	1,225,614	1,394,469
Stockholders' equity	107,580	119,572	147,613	212,824	307,964

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

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

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

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

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

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

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

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

	Year Ended June 30,				
	2015	2016	2017	2018	2019
	(in thousands)				
Reconciliation from Gross Profit to Adjusted Gross Profit					
Gross profit	\$ 81,802	\$ 132,616	\$ 176,023	\$ 228,330	\$ 313,782
Amortization of capitalized internal-use software costs	2,606	5,446	9,447	14,315	16,921
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	2,818	2,967	3,802	4,548	5,544
Adjusted Gross Profit	<u>\$ 87,226</u>	<u>\$ 141,029</u>	<u>\$ 189,272</u>	<u>\$ 247,193</u>	<u>\$ 336,247</u>

	Year Ended June 30,				
	2015	2016	2017	2018	2019
	(in thousands)				
Reconciliation from Total Recurring Revenues to Adjusted Recurring Gross Profit					
Total recurring revenues	\$ 144,069	\$ 220,104	\$ 288,448	\$ 363,525	\$ 456,836
Cost of recurring revenues	(46,366)	(66,131)	(85,399)	(104,009)	(125,211)
Recurring gross profit	97,703	153,973	203,049	259,516	331,625
Amortization of capitalized internal-use software costs	2,606	5,446	9,447	14,315	16,921
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	1,567	1,765	2,329	3,026	3,679
Adjusted Recurring Gross Profit	<u>\$ 101,876</u>	<u>\$ 161,184</u>	<u>\$ 214,825</u>	<u>\$ 276,857</u>	<u>\$ 352,225</u>

	Year Ended June 30,				
	2015	2016	2017	2018	2019
	(in thousands)				
Reconciliation from Net Income to Adjusted EBITDA					
Net income (loss)	\$ (13,972)	\$ (3,851)	\$ 6,718	\$ 38,598	\$ 53,823
Interest expense	—	—	—	—	—
Income tax expense (benefit)	105	177	651	(21,847)	4,223
Depreciation and amortization expense	8,609	13,873	21,027	30,202	34,564
EBITDA	(5,258)	10,199	28,396	46,953	92,610
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	13,496	18,199	27,794	31,817	41,014
Acquisition-related costs	—	—	—	191	—
Lease exit costs	—	—	—	2,336	423
Adjusted EBITDA	<u>\$ 8,238</u>	<u>\$ 28,398</u>	<u>\$ 56,190</u>	<u>\$ 81,297</u>	<u>\$ 134,047</u>

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

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

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

Overview

We are a cloud-based provider of payroll and human capital management (“HCM”) software solutions for medium-sized organizations, which we define as those having between 20 and 1,000 employees. Our comprehensive and easy-to-use solutions enable our clients to manage their workforces more effectively. Our product suite delivers a unified platform for professionals to make strategic decisions in the areas of payroll, core HR, workforce management, talent and benefits, all while promoting a modern workplace and improving employee engagement.

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

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

We believe there is a significant opportunity to grow our business by increasing our number of clients and we intend to invest in our business to achieve this purpose. We market and sell our solutions through our direct sales force. We have increased our sales and marketing expenses as we have added sales representatives and related sales and marketing personnel. We intend to continue to grow our sales and marketing organization across new and existing geographic territories. In addition to growing our number of clients, we intend to grow our revenue over the long term by increasing the number and quality of products that clients purchase from us. To do so, we must continue to enhance and grow the number of solutions we offer to advance our platform.

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

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

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. If general economic conditions were to deteriorate, including declines in private sector employment growth and business productivity, increases in the unemployment rate and changes in interest

rates, we may experience delays in our sales cycles, increased pressure from prospective clients to offer discounts and increased pressure from existing clients to renew expiring recurring revenue agreements for lower amounts.

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

Key Metrics

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

Recurring Revenue Growth

Our recurring revenue model and high annual revenue retention rates provide significant visibility into our future operating results and cash flow from operations. This visibility enables us to better manage and invest in our business. Total recurring revenue, which is comprised of recurring fees and interest income on funds held for clients, increased from \$288.4 million in fiscal 2017 to \$363.5 million in fiscal 2018, representing a 26% year-over-year increase. Total recurring revenue increased from \$363.5 million in fiscal 2018 to \$456.8 million in fiscal 2019, representing a 26% year-over-year increase. Total recurring revenue represented 96% of total revenue in fiscal 2017 and 2018 and 98% of total revenue in fiscal 2019.

Client Count Growth

We believe there is a significant opportunity to grow our business by increasing our number of clients. Excluding clients acquired as part of the BeneFLEX acquisition, we have increased the number of clients using our payroll and HCM software solutions from approximately 14,550 as of June 30, 2017 to approximately 20,200 as of June 30, 2019, representing a compound annual growth rate of approximately 18%. The table below sets forth the total number of clients using our payroll and HCM software solutions for the periods indicated, rounded to the nearest fifty.

	Year Ended June 30,		
	2017	2018	2019
Client Count	14,550	16,700	20,200

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

Annual Revenue Retention Rate

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

Adjusted Gross Profit, Adjusted Recurring Gross Profit and Adjusted EBITDA

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

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

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

	Year Ended June 30,		
	2017	2018	2019
	(in thousands)		
Adjusted Gross Profit	\$ 189,272	\$ 247,193	\$ 336,247
Adjusted Recurring Gross Profit	\$ 214,825	\$ 276,857	\$ 352,225
Adjusted EBITDA	\$ 56,190	\$ 81,297	\$ 134,047

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

Basis of Presentation

Revenues

Recurring Fees

We derive the majority of our revenues from recurring fees attributable to our cloud-based payroll and HCM software solutions. Recurring fees for each client generally include a base fee in addition to a fee based on the number of client employees and the number of products a client uses. We also charge fees attributable to our preparation of W-2 documents and annual required filings on behalf of our clients. Over the past three years, our client size has been on average over 100 employees. We derive revenue from a client based on the solutions purchased by the client, the number of client employees as well as the amount, type and timing of services provided with respect to those client employees. As such, the number of client employees on our system is not a good indicator of our financial results in any period. Recurring fees attributable to our cloud-based payroll and HCM solutions accounted for approximately 95%, 94% and 94% of our total revenues during the years ended June 30, 2017, 2018 and 2019, respectively.

While the majority of our agreements with clients are generally cancellable by the client on 60 days' notice or less, we also began entering into term arrangements in fiscal 2018, which are generally over two years in length. Our agreements do not include general rights of return and do not provide clients with the right to take possession of the

software supporting the services being provided. We recognize recurring fees in the period in which services are provided and the related performance obligations have been satisfied.

Interest Income on Funds Held for Clients

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

Implementation Services and Other

Implementation services and other revenues primarily consist of implementation fees charged to new clients for professional services provided to implement our payroll and HCM solutions. Implementations of our payroll solutions typically require only three to four weeks at which point the new client's payroll is first processed using our solution. We implement additional HCM products as requested by clients and leverage the data within our payroll solution to accelerate our implementation processes. With the adoption of Topic 606, we defer and amortize implementation fees related to our proprietary products over a period generally up to 24 months, which previously were recognized upon completion. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: "Financial Statements and Supplementary Data" for additional information regarding the adoption of Topic 606.

Cost of Revenues

Cost of Recurring Revenues

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

We capitalize a portion of our internal-use software costs, which are then all amortized as a cost of recurring revenues. We amortized \$9.4 million, \$14.3 million and \$16.9 million of capitalized internal-use software costs in fiscal 2017, 2018 and 2019, respectively.

Cost of Implementation Services and Other

Cost of implementation services and other consists primarily of employee-related expenses, including wages, stock-based compensation, bonuses and benefits involved in the implementation of our payroll and other HCM solutions for new and existing clients. With the adoption of Topic 606, cost of implementation services related to our proprietary products are capitalized and amortized over a period of 7 years, which previously were expensed as incurred. We intend to grow our business through acquisition of new clients, and doing so will require increased personnel to implement our solutions. Therefore, our cost of implementation services and other is expected to increase in absolute dollars for the foreseeable future. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: "Financial Statements and Supplementary Data" for additional information regarding the adoption of Topic 606.

Operating Expenses

Sales and Marketing

Sales and marketing expenses consist primarily of employee-related expenses for our direct sales and marketing staff, including wages, commissions, stock-based compensation, bonuses, benefits, marketing expenses and other related

costs. With the adoption of Topic 606, we capitalize certain selling and commission costs related to new contracts or purchases of additional services by our existing clients, which were previously expensed as incurred. Commissions are typically paid within two months after the start of service. Bonuses paid to sales staff for attainment of certain annual performance criteria are accrued in the fiscal year and are subsequently paid annually in the first fiscal quarter of the following year. We generally recognize these costs over a period of 7 years. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for additional information regarding the adoption of Topic 606.

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

Research and Development

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

We capitalize a portion of our development costs related to internal-use software. The timing of our capitalized development projects may affect the amount of development costs expensed in any given period. The table below sets forth the amounts of capitalized and expensed research and development expenses for each of fiscal 2017, 2018 and 2019.

	Year Ended June 30,		
	2017	2018	2019
	(in thousands)		
Capitalized portion of research and development	\$ 15,414	\$ 18,015	\$ 23,313
Expensed portion of research and development	29,098	37,645	50,329
Total research and development	\$ 44,512	\$ 55,660	\$ 73,642

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

General and Administrative

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

Other Income

Other income generally consists of interest income related to interest earned on our cash and cash equivalents and corporate investments, net of losses on disposals of property and equipment.

Results of Operations

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

	Year Ended June 30,		
	2017	2018	2019
	(in thousands)		
Consolidated Statements of Operations Data:			
Revenues:			
Recurring fees	\$ 284,817	\$ 354,432	\$ 436,955
Interest income on funds held for clients	3,631	9,093	19,881
Total recurring revenues	288,448	363,525	456,836
Implementation services and other	11,562	14,002	10,797
Total revenues	300,010	377,527	467,633
Cost of revenues:			
Recurring revenues	85,399	104,009	125,211
Implementation services and other	38,588	45,188	28,640
Total cost of revenues	123,987	149,197	153,851
Gross profit	176,023	228,330	313,782
Operating expenses:			
Sales and marketing	77,506	95,484	112,599
Research and development	29,098	37,645	50,329
General and administrative	62,123	79,252	94,630
Total operating expenses	168,727	212,381	257,558
Operating income	7,296	15,949	56,224
Other income			
Income before income taxes	7,369	16,751	58,046
Income tax expense (benefit)	651	(21,847)	4,223
Net income	\$ 6,718	\$ 38,598	\$ 53,823

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

	Year Ended June 30,		
	2017	2018	2019
Consolidated Statements of Operations Data:			
Revenues:			
Recurring fees	95 %	94 %	94 %
Interest income on funds held for clients	1 %	2 %	4 %
Total recurring revenues	96 %	96 %	98 %
Implementation services and other	4 %	4 %	2 %
Total revenues	100 %	100 %	100 %
Cost of revenues:			
Recurring revenues	28 %	28 %	27 %
Implementation services and other	13 %	12 %	6 %
Total cost of revenues	41 %	40 %	33 %
Gross profit	59 %	60 %	67 %
Operating expenses:			
Sales and marketing	26 %	25 %	24 %
Research and development	10 %	10 %	11 %
General and administrative	21 %	21 %	20 %
Total operating expenses	57 %	56 %	55 %
Operating income	2 %	4 %	12 %
Other income			
Income before income taxes	2 %	4 %	12 %
Income tax expense (benefit)	0 %	(6)%	0 %
Net income	2 %	10 %	12 %

Comparison of Fiscal Years Ended June 30, 2017, 2018 and 2019

Revenues

(\$ in thousands)

	Year Ended June 30,			Change from		Change from	
	2017			2017 to 2018		2018 to 2019	
	2017	2018	2019	\$	%	\$	%
Recurring fees	\$284,817	\$354,432	\$436,955	\$69,615	24 %	\$82,523	23 %
Percentage of total revenues	95 %	94 %	94 %				
Interest income on funds held for clients	\$ 3,631	\$ 9,093	\$ 19,881	\$ 5,462	150 %	\$10,788	119 %
Percentage of total revenues	1 %	2 %	4 %				
Implementation services and other	\$ 11,562	\$ 14,002	\$ 10,797	\$ 2,440	21 %	\$(3,205)	(23)%
Percentage of total revenues	4 %	4 %	2 %				

Recurring Fees

Recurring fees for the year ended June 30, 2019 increased by \$82.5 million, or 23%, to \$437.0 million from \$354.4 million for the year ended June 30, 2018. Recurring fees increased primarily as a result of incremental revenues from new and existing clients. Excluding clients acquired as part of the BeneFLEX acquisition, the number of clients using our payroll and HCM software solutions at June 30, 2019 increased by 21% to approximately 20,200 from approximately 16,700 at June 30, 2018.

Recurring fees for the year ended June 30, 2018 increased by \$69.6 million, or 24%, to \$354.4 million from \$284.8 million for the year ended June 30, 2017. Recurring fees increased primarily as a result of incremental revenues from new and existing clients. Excluding clients acquired as part of the BeneFLEX acquisition, the number of clients

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using our payroll and HCM software solutions at June 30, 2018 increased by 15% to approximately 16,700 from approximately 14,550 at June 30, 2017.

Interest Income on Funds Held for Clients

Interest income on funds held for clients for the year ended June 30, 2019 increased by \$10.8 million, or 119%, to \$19.9 million from \$9.1 million for the year ended June 30, 2018. Interest income on funds held for clients increased primarily as a result of higher average interest rates, increased average daily balances for funds held due to the addition of new clients to our client base and interest income from investing a larger portion of our funds held for clients in marketable securities.

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

Implementation Services and Other

Implementation services and other revenue for the year ended June 30, 2019 decreased by \$3.2 million, or 23%, to \$10.8 million from \$14.0 million for the year ended June 30, 2018. Implementation services and other revenue decreased primarily due to the change in the treatment of implementation fees related to our proprietary products. Historically, we recognized implementation fees upon completion. Starting July 1, 2018, we concluded that implementation fees related to our proprietary products are not separate performance obligations, and as a result, the related implementation fees are deferred and amortized generally over a period up to 24 months. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for additional information.

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

Cost of Revenues

(\$ in thousands)

	Year Ended June 30,			Change from 2017 to 2018		Change from 2018 to 2019	
	2017	2018	2019	\$	%	\$	%
Cost of recurring revenues	\$85,399	\$104,009	\$125,211	\$18,610	22 %	\$ 21,202	20 %
Percentage of recurring revenues	30 %	29 %	27 %				
Recurring gross margin	70 %	71 %	73 %				
Cost of implementation services and other	\$38,588	\$ 45,188	\$ 28,640	\$ 6,600	17 %	\$(16,548)	(37)%
Percentage of implementation services and other	334 %	323 %	265 %				
Implementation gross margin	(234)%	(223)%	(165)%				

Cost of Recurring Revenues

Cost of recurring revenues for the year ended June 30, 2019 increased by \$21.2 million, or 20%, to \$125.2 million from \$104.0 million for the year ended June 30, 2018. Cost of recurring revenues increased primarily as a result of the continued growth of our business, in particular, \$10.4 million in additional employee-related costs resulting from additional personnel necessary to provide services to new and existing clients, \$7.5 million in delivery and other processing-related fees and \$2.6 million in increased internal-use software amortization. Recurring gross margin increased from 71% in fiscal 2018 to 73% in fiscal 2019.

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

Cost of Implementation Services and Other

Cost of implementation services and other for the year ended June 30, 2019 decreased by \$16.5 million, or 37%, to \$28.6 million from \$45.2 million for the year ended June 30, 2018. The decrease in cost of implementation services and other was primarily due to the deferral and amortization of certain implementation costs over a period of 7 years related to our proprietary products upon the adoption of Topic 606 on July 1, 2018, partially offset by additional employee-related costs resulting from additional personnel. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for additional information regarding the adoption of Topic 606.

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

Operating Expenses

(\$ in thousands)

Sales and Marketing

	Year Ended June 30,			Change from 2017 to 2018		Change from 2018 to 2019	
	2017	2018	2019	\$	%	\$	%
Sales and marketing	\$77,506	\$95,484	\$112,599	\$17,978	23 %	\$17,115	18 %
Percentage of total revenues	26 %	25 %	24 %				

Sales and marketing expenses for the year ended June 30, 2019 increased by \$17.1 million, or 18%, to \$112.6 million from \$95.5 million for the year ended June 30, 2018. The increase in sales and marketing expense was primarily the result of \$14.2 million of additional employee-related costs from the expansion of our sales team net of the deferral and amortization of certain selling and commissions costs over a period of 7 years related to the adoption of Topic 606 on July 1, 2018. Refer to Note 2 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for additional information regarding the adoption of Topic 606.

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

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Research and Development

	Year Ended June 30,			Change from		Change from	
	2017	2018	2019	2017 to 2018		2018 to 2019	
				\$	%	\$	%
Research and development	\$29,098	\$37,645	\$50,329	\$ 8,547	29 %	\$12,684	34 %
Percentage of total revenues	10 %	10 %	11 %				

Research and development expenses for the year ended June 30, 2019 increased by \$12.7 million, or 34%, to \$50.3 million from \$37.6 million for the year ended June 30, 2018. The increase in research and development expenses was primarily the result of \$14.3 million of additional employee-related costs related to additional development personnel and \$2.3 million of additional stock-based compensation associated with our equity incentive plan, partially offset by higher year-over-year capitalized internal-use software costs of \$5.3 million.

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

General and Administrative

	Year Ended June 30,			Change from		Change from	
	2017	2018	2019	2017 to 2018		2018 to 2019	
				\$	%	\$	%
General and administrative	\$62,123	\$79,252	\$94,630	\$17,129	28 %	\$15,378	19 %
Percentage of total revenues	21 %	21 %	20 %				

General and administrative expenses for the year ended June 30, 2019 increased by \$15.4 million, or 19%, to \$94.6 million from \$79.3 million for the year ended June 30, 2018. The increase in general and administrative expense was primarily the result of \$7.5 million of additional employee-related costs and \$5.7 million in additional stock-based compensation associated with our equity incentive plan.

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

Other Income

	Year Ended June 30,			Change from		Change from	
	2017	2018	2019	2017 to 2018		2018 to 2019	
				\$	%	\$	%
Other income	\$ 73	\$ 802	\$ 1,822	\$ 729	999 %	\$ 1,020	127 %
Percentage of total revenues	0 %	0 %	0 %				

Other income for the year ended June 30, 2019 increased by \$1.0 million as compared to the year ended June 30, 2018. The increase in other income was primarily due to interest income from investing a portion of our excess cash and cash equivalents in marketable securities starting in July 2018, partially offset by loss on the disposal of property and equipment.

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

Income Tax Expense (Benefit)

	Year Ended June 30,			Change from 2017 to 2018		Change from 2018 to 2019	
	2017	2018	2019	\$	%	\$	%
Income tax expense (benefit)	\$ 651	\$(21,847)	\$4,223	\$(22,498)	*	\$26,070	*
Percentage of total revenues	0 %	(6)%	0 %				

* Not Meaningful

The difference in income tax expense (benefit) for the year ended June 30, 2019 as compared to the year ended June 30, 2018 was primarily due to \$41.3 million higher pre-tax income in the year ended June 30, 2019 in addition to a non-recurring tax benefit of \$22.8 million generated by the release of our valuation allowance during the year ended June 30, 2018.

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

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

Critical Accounting Policies and Significant Judgments and Estimates

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

Revenue Recognition

We adopted Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (“Topic 606”) effective as of July 1, 2018 using the modified retrospective method of transition, which limited the application of the new standard only to contracts that were not completed as of the effective date. Under Topic 606, we recognize revenue when we transfer control of goods or services to our customers in an amount that reflects the consideration to which we expect to be entitled to for those goods or services.

We derive our revenue from contracts with clients predominantly from recurring and non-recurring service fees. Recurring fees are derived from payroll and HR related services including time and attendance, employee administration and benefits enrollment and administration services. Payroll services are delivered on a weekly, biweekly, semi-monthly, or monthly basis depending upon the payroll frequency of the client and on an annual basis if a client selects W-2 preparation and processing services. HR related services are typically delivered on a monthly basis.

The majority of our recurring fees are satisfied over time as services are provided. The performance obligations related to payroll services are satisfied upon the processing of a client's payroll with the fee charged and collected based on a per employee per payroll frequency fee. The performance obligations related to time and attendance services and HR related services are satisfied over time each month with the fee charged and collected based on a per employee per month fee. For subscription based fees which can include payroll, time and attendance and HR related services, we recognize the applicable recurring fees over time each month with the fee charged and collected based on a per employee per month fee. We believe that the total fees charged to our clients is indicative of the standalone selling price as these fees are within the range of prices typically charged for our services to our clients. Even though our subscription-based services include multiple performance obligations, we do not believe it is meaningful to determine the standalone selling price for each service separately since these services are delivered and related revenue recognized within the same period.

We have certain optional performance obligations that are satisfied at a point in time including the sales of time clocks and W-2 preparation services.

Non-recurring service fees consist mainly of nonrefundable implementation fees, which involve setting the client up in, and loading data into, our cloud-based modules. These implementation activities are considered set-up activities. We have determined that the nonrefundable upfront fees provide certain clients with a material right to renew the contract. Implementation fees are deferred and amortized generally over a period up to 24 months.

Capitalized Internal-Use Software Costs

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

Internal-use software is amortized on a straight-line basis, generally over a 24 or 36-month period. We evaluate the useful lives of these assets on an annual basis and test for impairments whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to capitalized internal-use software during the years ended June 30, 2017, 2018 or 2019. We capitalized \$15.4 million, \$18.0 million, and \$23.3 million of internal-use software costs for the years ended June 30, 2017, 2018 and 2019, respectively, including stock-based compensation costs of \$1.8 million, \$2.0 million and \$2.8 million for the years ended June 30, 2017, 2018 and 2019, respectively. We amortized \$9.4 million, \$14.3 million, and \$16.9 million of capitalized internal-use software costs for the years ended June 30, 2017, 2018 and 2019, respectively. In fiscal 2017, fiscal 2018 and fiscal 2019, we developed significant additional functionality in several of our modules. This development resulted in an increase in capitalized internal-use software costs in fiscal 2019 as compared to fiscal 2018 and in fiscal 2018 as compared to fiscal 2017.

Goodwill and Intangible Assets

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill is not amortized, but instead is tested for impairment at the reporting unit level. If the fair value of the reporting unit is less than its carrying amount, we would record an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. We perform our annual impairment review of goodwill in our fiscal fourth quarter or when a triggering event occurs between annual impairment tests. No impairment was recorded in fiscal 2017, 2018 or 2019 as a result of our qualitative assessments over our single reporting segment.

Intangible assets are comprised primarily of client relationship acquisitions and are reported net of accumulated amortization on the consolidated balance sheets. Client relationships use the straight-line method of amortization over a seven to nine-year time frame, while the non-solicitation agreements uses the straight-line method of amortization over two to four year life of the agreements. Amortization expense associated with our intangible assets was \$1.5 million, \$1.7 million and \$2.3 million during the years ended June 30, 2017, 2018 and 2019, respectively. We test intangible assets for potential impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. There were no such events or changes in circumstances during the years ended June 30, 2017, 2018 or 2019.

Income Taxes

We account for federal income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets may be reduced by a valuation allowance to the extent we determine it is more likely than not that some portion or all of the deferred tax assets will not be realized. The valuation of deferred tax assets requires judgment in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns and future profitability. Our accounting for deferred tax consequences represents the best estimate of those future events.

In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. Based on the amount of positive evidence present from cumulative income in recent years, we released a substantial portion of our valuation allowance during the year ended June 30, 2018.

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

Liquidity and Capital Resources

Our primary liquidity needs are related to the funding of general business requirements, including working capital requirements, research and development, and capital expenditures. The share repurchase program completed during the first quarter of fiscal 2019 was funded by our cash flows from operations. As of June 30, 2019, our principal source of liquidity was \$132.5 million of cash and cash equivalents and \$30.0 million of total corporate investments. In July 2018, we started investing portions of our excess cash and cash equivalents in highly liquid, investment-grade marketable securities. These investments consist of commercial paper, asset-backed debt securities, corporate debt issuances and U.S. Treasury securities with credit quality ratings of A-1 or higher. We believe that our investments in unrealized loss positions as of June 30, 2019 were not other-than-temporarily impaired, nor has any event occurred subsequent to that date that would change that conclusion.

In order to grow our business, we intend to increase our personnel and related expenses and to make significant investments in our platform, data centers and general infrastructure. The timing and amount of these investments will vary based on the rate at which we can add new clients and new personnel and the scale of our module development, data centers and other activities. Many of these investments will occur in advance of our experiencing any direct benefit from them, which could negatively impact our liquidity and cash flows during any particular period and may make it difficult to determine if we are effectively allocating our resources. However, we expect to fund our operations, capital expenditures and other investments principally with cash flows from operations, and to the extent that our liquidity needs exceed our cash from operations, we would look to our cash on hand and corporate investments and utilize our credit

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facility that we recently entered into in July 2019 to satisfy those needs. Refer to Note 17 of the Notes to the Consolidated Financial Statements included in Part II, Item 8: “Financial Statements and Supplementary Data” for additional detail on the credit agreement.

Funds held for clients and client fund obligations will vary substantially from period to period as a result of the timing of payroll and tax obligations due. Our payroll processing activities involve the movement of significant funds from accounts of employers to employees and relevant taxing authorities. Though we debit a client’s account prior to any disbursement on its behalf, there is a delay between our payment of amounts due to employees and taxing and other regulatory authorities and when the incoming funds from the client to cover these amounts payable actually clear into our operating accounts. We currently have agreements with eleven banks to execute ACH and wire transfers to support our client payroll and tax services. We believe we have sufficient capacity under these ACH arrangements to handle transaction volumes for the foreseeable future.

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

Cash Flows

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

	Year Ended June 30,		
	2017⁽¹⁾	2018⁽¹⁾	2019
Net cash provided by operating activities	\$ 61,980	\$ 97,866	\$ 115,032
Cash flows from investing activities:			
Purchases of available-for-sale securities and other	—	(196,597)	(250,685)
Proceeds from sales and maturities of available-for-sale securities	—	73,044	246,243
Capitalized internal-use software costs	(13,641)	(15,638)	(20,142)
Purchases of property and equipment	(21,338)	(21,676)	(11,280)
Lease allowances used for tenant improvements	(2,845)	(11,754)	(7,480)
Acquisition of business, net of cash and funds held for clients' cash and cash equivalents	—	(6,658)	—
Net cash used in investing activities	(37,824)	(179,279)	(43,344)
Cash flows from financing activities:			
Net change in client fund obligations	(297,163)	281,467	168,855
Payment of contingent consideration	—	—	(1,000)
Repurchases of common shares	—	—	(34,991)
Proceeds from exercise of stock options	34	—	85
Proceeds from employee stock purchase plan	3,677	4,304	5,982
Taxes paid related to net share settlement of equity awards	(11,342)	(10,554)	(24,207)
Excess tax benefits from stock-based compensation	447	—	—
Net cash provided by (used in) financing activities	(304,347)	275,217	114,724
Net change in cash, cash equivalents and funds held for clients' cash and cash equivalents	<u>\$ (280,191)</u>	<u>\$ 193,804</u>	<u>\$ 186,412</u>

⁽¹⁾ Certain amounts have been reclassified to reflect the adoption of Accounting Standards Update (“ASU”) No. 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force).”

Operating Activities

Net cash provided by operating activities was \$62.0 million, \$97.9 million and \$115.0 million for the years ended June 30, 2017, 2018 and 2019, respectively.

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The increase in net cash provided by operating activities from fiscal 2018 to fiscal 2019 was primarily due to improved operating results after adjusting for non-cash items including stock-based compensation expense, depreciation and amortization expense and deferred income tax expense (benefit), partially offset by changes in operating assets and liabilities, mostly driven by changes in deferred contract costs and tenant improvement allowances. The increase in net cash provided by operating activities from fiscal 2017 to fiscal 2018 was primarily due to improved operating results after adjusting for non-cash items, including stock-based compensation expense and depreciation and amortization expense partially offset by the change in deferred income tax related to non-cash tax adjustments. Refer to Note 11 of the Notes to Consolidated Financial Statements included in Part II, Item 8: "Financial Statements and Supplementary Data" for additional detail related to the change in deferred income tax. The increase was also due to an additional \$8.9 million received for tenant improvement allowances.

Investing Activities

Net cash used in investing activities was \$37.8 million, \$179.3 million and \$43.3 million, for the years ended June 30, 2017, 2018 and 2019, respectively. The net cash used in investing activities is significantly impacted by the timing of purchases and sales and maturities of investments as we invest a portion of the funds held for clients in highly liquid, investment-grade marketable securities. The amount of funds held for clients invested will vary based on timing of client funds collected and payments due to client employees and taxing and other regulatory authorities. Beginning in July 2018, we also began investing portions of our excess cash in marketable securities.

The change in net cash used in investing activities from fiscal 2018 to fiscal 2019 was primarily due to an increase in proceeds from sales and maturities of available-for-sale securities of \$173.2 million, partially offset by an increase in purchases of available-for-sale securities and other of \$54.1 million during the year ended June 30, 2019 as compared to the year ended June 30, 2018. Other changes in net cash used in investing activities were primarily due to \$6.7 million in costs related to the acquisition of BeneFLEX during the year ended June 30, 2018 and decreases in purchases of property and equipment and lease allowances used for tenant improvements of \$10.4 million and \$4.3 million, respectively. The change in net cash used in investing activities from fiscal 2017 to fiscal 2018 was primarily due to \$196.6 million in purchases of available-for-sale securities and other, partially offset by \$73.0 million in sales and maturities available-for-sales securities as we started investing during fiscal 2018 for the first time. Other changes in investing activities were primarily due to an additional \$8.9 million in lease allowances used for tenant improvements and \$6.7 million in net cash used to acquire BeneFLEX during fiscal 2018.

Financing Activities

Net cash provided by (used in) financing activities was \$(304.3) million, \$275.2 million and \$114.7 million for the years ended June 30, 2017, 2018 and 2019, respectively. The change in net cash provided by (used in) financing activities from fiscal 2018 to fiscal 2019 was primarily the result of a decrease of \$112.6 million due to the timing of client funds collected and related remittance of those funds to client employees and taxing authorities, \$35.0 million in repurchases of common shares during fiscal 2019 and \$13.7 million in additional taxes paid related to net share settlement of equity awards. The change in net cash provided by (used in) financing activities from fiscal 2017 to fiscal 2018 was primarily the result of an increase of \$578.6 million due to the timing of client funds collected and related remittance of those funds to client employees and taxing authorities, partially offset by \$0.8 million increase in taxes paid related to net share settlement of equity awards.

Contractual Obligations and Commitments

Our principal commitments consist of operating lease obligations. The following table summarizes our contractual obligations at June 30, 2019:

	Payment Due By Fiscal Period				
	Total	2020	2021- 2022	2023- 2024	Thereafter
Operating lease obligations	\$108,178	\$10,449	\$20,650	\$17,678	\$ 59,401
Unconditional purchase obligations	10,869	4,990	5,879	—	—
	<u>\$119,047</u>	<u>\$15,439</u>	<u>\$26,529</u>	<u>\$17,678</u>	<u>\$ 59,401</u>

Capital Expenditures

We expect to continue to invest in capital spending as we continue to grow our business and expand and enhance our operating facilities, data centers and technical infrastructure. Future capital requirements will depend on many factors, including our rate of sales growth. In the event that our sales growth or other factors do not meet our expectations, we may eliminate or curtail capital projects in order to mitigate the impact on our use of cash. Capital expenditures were \$21.3 million, \$21.7 million and \$11.3 million for the years ended June 30, 2017, 2018 and 2019, respectively, exclusive of capitalized internal-use software costs of \$13.6 million, \$15.6 million, and \$20.1 million for the same periods, respectively. We also spent \$2.8 million, \$11.8 million and \$7.5 million in fiscal 2017, fiscal 2018, and fiscal 2019, respectively, on capital expenditures for which we received reimbursement for tenant improvement allowances.

Off-Balance Sheet Arrangements

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

New Accounting Pronouncements

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

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

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

Interest Rate Risk

As of June 30, 2019, we had cash and cash equivalents of \$132.5 million, total corporate investments of \$30.0 million and funds held for clients of \$1,394.5 million. We deposit our cash and cash equivalents and significant portions of our funds held for clients in demand deposit accounts with various financial institutions. We invest portions of our excess cash and cash equivalents and funds held for clients in marketable securities including commercial paper, corporate bonds, asset-backed securities and U.S. treasury securities which were classified as available-for-sale securities as of June 30, 2019. Our investment policy is focused on generating higher yields from these investments while preserving liquidity and capital. However, as a result of our investing activities, we are exposed to changes in interest rates that may materially affect our financial statements.

In a falling rate environment, a decline in interest rates would decrease our interest income earned on both cash and cash equivalents and funds held for clients. An increase in the overall interest rate environment may cause the

market value of our investments in fixed rate available-for-sale securities to decline. If we are forced to sell some or all of these securities at lower market values, we may incur investment losses. However, because we classify all marketable securities as available-for-sale, no gains or losses are recognized due to changes in interest rates until such securities are sold or decreases in fair value are deemed to be other-than-temporary. We have not recorded any other-than-temporary impairment losses to date.

Based upon a sensitivity model that measures market value changes caused by interest rate fluctuations, an immediate 25-basis point increase in interest rates would have resulted in a decrease in the market value of our available-for-sale securities by \$0.1 million as of June 30, 2019. A 25-basis point decrease in interest rates would have resulted in a \$0.1 million increase in the market value of our available-for-sale securities as of June 30, 2019. Fluctuations in the value of our available-for-sale securities caused by changes in interest rates are recorded in other comprehensive income and are only realized if we sell the underlying securities.

Inflation Risk

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

Item 8. Financial Statements and Supplementary Data.

The information required by this item is incorporated by reference to the consolidated financial statements and accompanying notes set forth on pages F-1 through F-32 of this Annual Report on Form 10-K.

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

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2019, the end of the period covered by this Annual Report on Form 10-K. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

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

Our management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2019, based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2013 framework). Based on this evaluation under the Internal Control—Integrated Framework our Chief Executive Officer and Chief Financial Officer have concluded that our internal control over financial reporting was effective as of June 30, 2019.

Our independent registered public accounting firm, which has audited our financial statements, has also audited the effectiveness of our internal control over financial reporting as of June 30, 2019, as stated in their report, which is included in Item 15(a)(1) of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Effective July 1, 2018, we adopted Accounting Standard Codification Topic 606, Revenue from Contracts with Customers (“ASC 606”). Changes were made to the relevant business processes and the related control activities in order to monitor and maintain appropriate controls over financial reporting.

Limitations on Controls

Our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information required by Part III, Item 10, will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

Item 11. Executive Compensation

Information required by Part III, Item 11, will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

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

Information required by Part III, Item 12, will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

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

Information required by Part III, Item 13, will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Information required by Part III, Item 14, will be included in our Proxy Statement relating to our 2020 annual meeting of stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended June 30, 2019, and is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents Filed with Report

(1) *Financial Statements.*

[Report of Independent Registered Public Accounting Firm](#) F-2

[Consolidated Balance Sheets as of June 30, 2018 and 2019](#) F-5

[Consolidated Statements of Operations and Comprehensive Income for the years ended June 30, 2017, 2018 and 2019](#) F-6

[Consolidated Statements of Changes in Stockholders' Equity for the years ended June 30, 2017, 2018 and 2019](#) F-7

[Consolidated Statements of Cash Flows for the years ended June 30, 2017, 2018 and 2019](#) F-8

[Notes to the Consolidated Financial Statements](#) F-9

(2) *Exhibits.*

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

Item 16. Form 10-K Summary

None.

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
2.1	Share Exchange Agreement, dated November 7, 2013.	S-1	333-193661	2.1	January 30, 2014
3.1	First Amended and Restated Certificate of Incorporation of the Registrant.	S-1/A	333-193661	3.2	February 14, 2014
3.2	Amended and Restated By-Laws of the Registrant.	10-K	001-36348	3.2	August 11, 2017
4.1	Amended and Restated Investor Rights Agreement, dated June 29, 2012.	S-1	333-193661	4.1	January 30, 2014
10.1	Form of Indemnification Agreement for directors and officers.	S-1	333-193661	10.2	January 30, 2014
10.2†	2008 Equity Incentive Plan and forms of agreement thereunder.	S-1	333-193661	10.3	January 30, 2014
10.2.1†	First Amendment to the 2008 Equity Incentive Plan, dated August 5, 2010.	S-1	333-193661	10.3.1	January 30, 2014
10.2.2†	Second Amendment to the 2008 Equity Incentive Plan, dated June 29, 2012.	S-1	333-193661	10.3.2	January 30, 2014
10.3†	2014 Equity Incentive Plan and forms of agreement thereunder.	S-1/A	333-193661	10.4	February 14, 2014
10.4†	Third Amended and Restated Executive Employment Agreement between Paylocity Corporation and Steven R. Beauchamp, dated February 7, 2014.	S-1/A	333-193661	10.5	February 14, 2014
10.5†	Second Amended and Restated Executive Employment Agreement between Paylocity Corporation and Michael R. Haske, dated February 7, 2014.	S-1/A	333-193661	10.7	February 14, 2014
10.6	Office Lease between 3850 Wilke LLC and Paylocity Corporation, dated January 12, 2007.	S-1	333-193661	10.8	January 30, 2014
10.7.1	Amendment to Office Lease, dated January 5, 2011.	S-1	333-193661	10.8.1	January 30, 2014
10.7.2	Amendment to Office Lease, dated May 6, 2013.	S-1	333-193661	10.8.2	January 30, 2014
10.7.3	Multi-Tenant Office Lease Agreement, dated June 1, 2016, by and between Paylocity Corporation and RPAI Schaumburg American Lane, L.L.C.	8-K	001-36348	10.1	June 2, 2016
10.8†	2014 Employee Stock Purchase Plan.	S-1/A	333-193661	10.9	February 14, 2014
10.10†	Executive Employment Agreement between Paylocity Corporation and Mark S. Kinsey, dated May 1, 2015.	10-K	001-36348	10.11	August 12, 2016

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Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.11†	Executive Employment Agreement between Paylocity Corporation and Edward W. Gaty, dated August 8, 2016.	8-K	001-36348	10.1	August 9, 2016
10.12†	Executive Employment Agreement between Paylocity Corporation and Toby J. Williams, dated September 18, 2017.	10-Q	001-36348	10.1	November 3, 2017
14.1	Code of Business Conduct and Ethics.	10-K	001-36348	14.1	August 22, 2014
21.1	List of Subsidiaries of the Registrant.	10-K	001-36348	21.1	August 10, 2018
23.1*	Consent of KPMG LLP, Independent Registered Public Accounting Firm.				
24.1*	Power of Attorney (see page 64 to this Annual Report on Form 10-K).				
31.1*	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.				
31.2*	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.				
32.1**	Certification of Chief Executive Officer Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.				
32.2**	Certification of Chief Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350 as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.				
101.INS*	XBRL Instance Document.				
101.SCH*	XBRL Taxonomy Extension Schema.				
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.				
101.LAB*	XBRL Taxonomy Extension Label Linkbase.				
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase.				
101.DEF*	XBRL Taxonomy Extension Definition Linkbase.				

† Management contract, compensatory plan or arrangement.

* Filed herewith.

** Furnished herewith.

SIGNATURES

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

Date: August 9, 2019

PAYLOCITY HOLDING CORPORATION

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

SIGNATURES AND POWER OF ATTORNEY

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

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Steven R. Beauchamp</u> <i>Steven R. Beauchamp</i>	Chief Executive Officer (Principal Executive Officer) and Director	August 9, 2019
<u>/s/ Toby J. Williams</u> <i>Toby J. Williams</i>	Chief Financial Officer (Principal Financial Officer)	August 9, 2019
<u>/s/ Andrew Cappelletti</u> <i>Andrew Cappelletti</i>	Chief Accounting Officer (Principal Accounting Officer)	August 9, 2019
<u>/s/ Steven I. Sarowitz</u> <i>Steven I. Sarowitz</i>	Chairman of the Board of Directors	August 9, 2019
<u>/s/ Virginia G. Breen</u> <i>Virginia G. Breen</i>	Director	August 9, 2019
<u>/s/ Ellen Carnahan</u> <i>Ellen Carnahan</i>	Director	August 9, 2019
<u>/s/ Jeffrey T. Diehl</u> <i>Jeffrey T. Diehl</i>	Director	August 9, 2019
<u>/s/ Andres D. Reiner</u> <i>Andres D. Reiner</i>	Director	August 9, 2019
<u>/s/ Ronald V. Waters, III</u> <i>Ronald V. Waters, III</i>	Director	August 9, 2019

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Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
Paylocity Holding Corporation:

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

We have audited the accompanying consolidated balance sheets of Paylocity Holding Corporation and subsidiaries (the Company) as of June 30, 2019 and 2018, the related consolidated statements of operations and comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2019, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of June 30, 2019, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2019 and 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2019, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2019 based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Change in Accounting Principle

As discussed in Note 2 to the consolidated financial statements, the Company has changed its method of accounting for revenues and related costs for the year ended June 30, 2019 due to the adoption of Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606), effective July 1, 2018.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Controls and Procedures.

Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

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

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such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Evaluation of implementation services

As discussed in Note 2(s) to the Company's consolidated financial statements, the Company determined that implementation services for its proprietary products are not a separate performance obligation under Topic 606 for contracts entered into after July 1, 2018. This determination required the Company to apply significant judgment in evaluating whether the implementation services provide an incremental benefit to the customer when considering the inability of third parties to perform the Company's implementation services.

We identified the determination that the implementation services are not a separate performance obligation as a critical audit matter. The principal considerations included the degree of subjectivity involved in assessing the incremental benefit to the customer, if any, and determining that third parties were no longer able to perform such implementation services.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's revenue recognition process, including controls to assess if the accounting policy determinations are reflective of the actual underlying business transactions. We obtained and inspected internal and external documentation to assess if third parties were able to perform implementation services subsequent to June 30, 2018. We also evaluated the Company's conclusion that no incremental benefit is provided to the customer, through inspection of internal documentation and consideration of relevant publicly available information about the Company and its competitors.

Determination of capitalized internal-use software development costs

As discussed in Notes 2(g) and 6 to the consolidated financial statements, the Company capitalizes certain internal-use software costs related to new products as well as existing products when those costs will result in significant additional functionality. The Company's capitalized internal-use software asset, net of accumulated amortization,

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was \$27 million as of June 30, 2019. The Company capitalized \$23 million of internal-use software costs during the year ended June 30, 2019.

We identified the determination of capitalized internal-use software development costs as a critical audit matter because of the degree of subjectivity involved in assessing which projects met the capitalization criteria.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's process to capitalize internal-use software development costs, including controls over the determination of which software development projects met the capitalization criteria. We evaluated the Company's current year software project capitalization conclusions, and discussed the objective and status of the software projects with IT department management to assess those conclusions. We also assessed the reliability of the Company's conclusions through confirmations with a sample of individual software developers regarding the nature of their development activities.

/s/ KPMG LLP

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

Chicago, Illinois
August 9, 2019

PAYLOCITY HOLDING CORPORATION
Consolidated Balance Sheets
(in thousands, except per share data)

	<u>As of June 30,</u>	
	<u>2018</u>	<u>2019</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 137,193	\$ 132,476
Corporate investments	732	29,314
Accounts receivable, net	3,453	4,358
Deferred contract costs	—	21,677
Prepaid expenses and other	11,248	13,895
	<u>152,626</u>	<u>201,720</u>
Funds held for clients	1,225,614	1,394,469
	<u>1,378,240</u>	<u>1,596,189</u>
Total current assets	1,378,240	1,596,189
Capitalized internal-use software, net	21,094	27,486
Property and equipment, net	62,029	70,056
Intangible assets, net	13,002	10,751
Goodwill	9,590	9,590
Long-term deferred contract costs	—	81,422
Long-term prepaid expenses and other	1,504	1,975
Deferred income tax assets, net	22,140	6,472
	<u>22,140</u>	<u>6,472</u>
Total assets	<u>\$ 1,507,599</u>	<u>\$ 1,803,941</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,990	\$ 3,954
Accrued expenses	42,241	57,625
	<u>45,231</u>	<u>61,579</u>
Total current liabilities before client fund obligations	45,231	61,579
Client fund obligations	1,225,614	1,394,469
	<u>1,270,845</u>	<u>1,456,048</u>
Total current liabilities	1,270,845	1,456,048
Deferred rent	22,812	31,263
Other long-term liabilities	1,118	1,723
Deferred income tax liabilities, net	—	6,943
	<u>24,930</u>	<u>39,930</u>
Total liabilities	<u>\$ 1,294,775</u>	<u>\$ 1,495,977</u>
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000 authorized, no shares issued and outstanding at June 30, 2018 and June 30, 2019	\$ —	\$ —
Common stock, \$0.001 par value, 155,000 shares authorized at June 30, 2018 and June 30, 2019; 52,758 shares issued and outstanding at June 30, 2018 and 53,075 shares issued and outstanding at June 30, 2019	53	53
Additional paid-in capital	219,588	207,982
Retained earnings (accumulated deficit)	(6,678)	99,817
Accumulated other comprehensive income (loss)	(139)	112
	<u>212,824</u>	<u>307,964</u>
Total stockholders' equity	\$ 212,824	\$ 307,964
Total liabilities and stockholders' equity	<u>\$ 1,507,599</u>	<u>\$ 1,803,941</u>

See accompanying notes to consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Consolidated Statements of Operations and Comprehensive Income
(in thousands, except per share data)

	For the Years Ended June 30,		
	2017	2018	2019
Revenues:			
Recurring fees	\$ 284,817	\$ 354,432	\$ 436,955
Interest income on funds held for clients	3,631	9,093	19,881
	<u>288,448</u>	<u>363,525</u>	<u>456,836</u>
Implementation services and other	11,562	14,002	10,797
Total revenues	<u>300,010</u>	<u>377,527</u>	<u>467,633</u>
Cost of revenues:			
Recurring revenues	85,399	104,009	125,211
Implementation services and other	38,588	45,188	28,640
Total cost of revenues	<u>123,987</u>	<u>149,197</u>	<u>153,851</u>
Gross profit	<u>176,023</u>	<u>228,330</u>	<u>313,782</u>
Operating expenses:			
Sales and marketing	77,506	95,484	112,599
Research and development	29,098	37,645	50,329
General and administrative	62,123	79,252	94,630
Total operating expenses	<u>168,727</u>	<u>212,381</u>	<u>257,558</u>
Operating income	7,296	15,949	56,224
Other income	73	802	1,822
Income before income taxes	7,369	16,751	58,046
Income tax expense (benefit)	651	(21,847)	4,223
Net income	<u>\$ 6,718</u>	<u>\$ 38,598</u>	<u>\$ 53,823</u>
Other comprehensive income (loss), net of tax			
Unrealized gains (losses) on securities, net of tax	—	(139)	251
Total other comprehensive income (loss), net of tax	—	(139)	251
Comprehensive income	<u>\$ 6,718</u>	<u>\$ 38,459</u>	<u>\$ 54,074</u>
Net income per share:			
Basic	<u>\$ 0.13</u>	<u>\$ 0.74</u>	<u>\$ 1.02</u>
Diluted	<u>\$ 0.12</u>	<u>\$ 0.70</u>	<u>\$ 0.97</u>
Weighted-average shares used in computing net income per share:			
Basic	<u>51,415</u>	<u>52,425</u>	<u>52,914</u>
Diluted	<u>54,057</u>	<u>54,887</u>	<u>55,414</u>

See accompanying notes to consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Consolidated Statements of Changes in Stockholders' Equity
(in thousands)

	Stockholders' Equity					
	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
Balances at June 30, 2016	51,132	\$ 51	\$ 171,515	\$ (51,994)	\$ —	\$ 119,572
Stock-based compensation	—	—	28,507	—	—	28,507
Stock options exercised	691	1	8,550	—	—	8,551
Issuance of common stock upon vesting of restricted stock units	255	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	127	—	3,677	—	—	3,677
Net settlement for taxes and/or exercise price related to equity awards	(467)	—	(19,859)	—	—	(19,859)
Excess tax benefits from stock-based compensation	—	—	447	—	—	447
Net income	—	—	—	6,718	—	6,718
Balances at June 30, 2017	51,738	\$ 52	\$ 192,837	\$ (45,276)	\$ —	\$ 147,613
Stock-based compensation	—	—	32,378	—	—	32,378
Stock options exercised	839	1	8,001	—	—	8,002
Issuance of common stock upon vesting of restricted stock units	452	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	108	—	4,304	—	—	4,304
Net settlement for taxes and/or exercise price related to equity awards	(379)	—	(17,932)	—	—	(17,932)
Unrealized losses on securities, net of tax	—	—	—	—	(139)	(139)
Net income	—	—	—	38,598	—	38,598
Balances at June 30, 2018	52,758	\$ 53	\$ 219,588	\$ (6,678)	\$ (139)	\$ 212,824
Cumulative effect of change in accounting policy (adoption of Topic 606)	—	—	—	52,672	—	52,672
Stock-based compensation	—	—	41,525	—	—	41,525
Stock options exercised	378	—	4,882	—	—	4,882
Issuance of common stock upon vesting of restricted stock units	660	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	116	—	5,982	—	—	5,982
Net settlement for taxes and/or exercise price related to equity awards	(395)	—	(29,004)	—	—	(29,004)
Repurchases of common shares	(442)	—	(34,991)	—	—	(34,991)
Unrealized gains on securities, net of tax	—	—	—	—	251	251
Net income	—	—	—	53,823	—	53,823
Balances at June 30, 2019	53,075	\$ 53	\$ 207,982	\$ 99,817	\$ 112	\$ 307,964

See accompanying notes to consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Consolidated Statements of Cash Flows
(in thousands)

	For the Years Ended June 30,		
	2017⁽¹⁾	2018⁽¹⁾	2019
Cash flows from operating activities:			
Net income	\$ 6,718	\$ 38,598	\$ 53,823
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock-based compensation expense	26,734	30,354	38,765
Depreciation and amortization expense	21,027	30,202	34,564
Deferred income tax expense (benefit)	152	(21,870)	4,134
Provision for doubtful accounts	113	296	283
Net accretion of discounts and amortization of premiums on available-for-sale securities	—	(443)	(2,230)
Net realized losses on sales of available-for-sale securities	—	2	—
Loss on disposal of equipment	253	227	454
Changes in operating assets and liabilities:			
Accounts receivable	(472)	(1,494)	(1,188)
Deferred contract costs	—	—	(34,992)
Prepaid expenses and other	(2,074)	(2,141)	389
Accounts payable	219	740	(75)
Accrued expenses	6,465	11,641	13,625
Tenant improvement allowance	2,845	11,754	7,480
Net cash provided by operating activities	<u>61,980</u>	<u>97,866</u>	<u>115,032</u>
Cash flows from investing activities:			
Purchases of available-for-sale securities and other	—	(196,597)	(250,685)
Proceeds from sales and maturities of available-for-sale securities	—	73,044	246,243
Capitalized internal-use software costs	(13,641)	(15,638)	(20,142)
Purchases of property and equipment	(21,338)	(21,676)	(11,280)
Lease allowances used for tenant improvements	(2,845)	(11,754)	(7,480)
Acquisition of business, net of cash and funds held for clients' cash and cash equivalents	—	(6,658)	—
Net cash used in investing activities	<u>(37,824)</u>	<u>(179,279)</u>	<u>(43,344)</u>
Cash flows from financing activities:			
Net change in client fund obligations	(297,163)	281,467	168,855
Payment of contingent consideration	—	—	(1,000)
Repurchases of common shares	—	—	(34,991)
Proceeds from exercise of stock options	34	—	85
Proceeds from employee stock purchase plan	3,677	4,304	5,982
Taxes paid related to net share settlement of equity awards	(11,342)	(10,554)	(24,207)
Excess tax benefits from stock-based compensation	447	—	—
Net cash provided by (used in) financing activities	<u>(304,347)</u>	<u>275,217</u>	<u>114,724</u>
Net change in cash, cash equivalents and funds held for clients' cash and cash equivalents	(280,191)	193,804	186,412
Cash, cash equivalents and funds held for clients' cash and cash equivalents—beginning of year	1,326,118	1,045,927	1,239,731
Cash, cash equivalents and funds held for clients' cash and cash equivalents—end of year	<u>\$ 1,045,927</u>	<u>\$ 1,239,731</u>	<u>\$ 1,426,143</u>
Supplemental Disclosure of Non-Cash Investing and Financing Activities			
Build-out allowances received from landlords	\$ —	\$ 1,956	\$ 1,264
Purchase of property and equipment and internal-use software, accrued but not paid	<u>\$ 667</u>	<u>\$ 659</u>	<u>\$ 4,260</u>
Supplemental Disclosure of Cash Flow Information			
Cash paid (refunds received) for income taxes	<u>\$ 28</u>	<u>\$ (53)</u>	<u>\$ 412</u>
Reconciliation of cash, cash equivalents and funds held for clients' cash and cash equivalents to the Consolidated Balance Sheets			
Cash and cash equivalents	\$ 103,468	\$ 137,193	\$ 132,476
Funds held for clients' cash and cash equivalents	942,459	1,102,538	1,293,667
Total cash, cash equivalents and funds held for clients' cash and cash equivalents	<u>\$ 1,045,927</u>	<u>\$ 1,239,731</u>	<u>\$ 1,426,143</u>

(1) Certain amounts have been reclassified to reflect the adoption of Accounting Standards Update ("ASU") No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)."

See accompanying notes to consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Notes to the Consolidated Financial Statements
(all amounts in thousands, except per share data)

(1) Organization and Description of Business

Paylocity Holding Corporation (the “Company”) is a cloud-based provider of payroll and human capital management software solutions for medium-sized organizations. Services are provided in a Software-as-a-Service (“SaaS”) delivery model utilizing the Company’s cloud-based platform. The Company’s comprehensive product suite delivers a unified platform that allows clients to make strategic decisions in the areas of payroll, core HR, workforce management, talent and benefits.

(2) Summary of Significant Accounting Policies

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

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

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

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

The Company began investing corporate funds in available-for-sale securities during the first quarter of fiscal 2019, and as a result, reclassified \$732 as of June 30, 2018 from Prepaid expenses and other on the consolidated balance sheets to Corporate investments in order to conform to the current year’s presentation.

(b) *Concentrations of Risk*

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

(c) *Cash and Cash Equivalents*

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

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

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

Marketable securities classified as available-for-sale are recorded at fair value on the consolidated balance sheets. Unrealized gains and losses, net of applicable income taxes, are reported as other comprehensive income (loss) in

the consolidated statements of operations and comprehensive income. Interest on marketable securities included in funds held for clients is reported as interest income on funds held for clients and interest on corporate investments is reported as other income on the consolidated statements of operations and comprehensive income, respectively.

The Company reviews the composition of its portfolio for any available-for-sale security that has a fair value that falls below its amortized cost. If any security fits this criterion, the Company further evaluates whether other-than-temporary impairment exists by considering whether the Company has the intent and ability to retain the security for a period of time sufficient enough to allow for anticipated fair value recovery. The Company did not record any other-than-temporary impairment charges during the years ended June 30, 2018 or 2019.

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

(e) *Accounts Receivable*

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

Activity in the allowance for doubtful accounts was as follows:

	For the Years Ended June 30,		
	2017	2018	2019
Balance at the beginning of the year	\$ 193	\$ 266	\$ 375
Charged to expense	113	296	283
Write-offs	(40)	(187)	(185)
Balance at the end of the year	<u>\$ 266</u>	<u>\$ 375</u>	<u>\$ 473</u>

(f) *Prepaid Expenses and Other Assets*

Prepaid expenses and other assets consist primarily of prepaid licensing fees, prepaid insurance premiums, deposits with vendors, and time clocks available for sale or lease.

(g) *Capitalized Internal-Use Software*

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

Capitalized internal-use software costs are amortized on a straight-line basis over the estimated useful lives, generally over a 24 or 36-month period. Management evaluates the useful lives of these assets on an annual basis and

tests for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

(h) *Property and Equipment and Long-Lived Assets*

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

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

(i) *Intangible Assets, Net of Accumulated Amortization*

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

(j) *Goodwill*

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

The Company performs its annual impairment review of goodwill in its fiscal fourth quarter or when a triggering event occurs between annual impairment tests. No impairment was recorded in fiscal 2017, 2018 or 2019 as a result of the Company's qualitative assessments over its single reporting segment.

(k) *Deferred Rent*

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

(l) *Income Taxes*

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

Deferred tax assets may be reduced by a valuation allowance to the extent we determine it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management judgment is required in

determining the period in which the reversal of a valuation allowance should occur. The Company is required to consider all available evidence, both positive and negative, such as historical levels of income and future forecasts of taxable income among other items, in determining whether a full or partial release of its valuation allowance is required. The Company is also required to schedule future taxable income in accordance with accounting standards that address income taxes to assess the appropriateness of a valuation allowance, which further requires the exercise of significant management judgment. The Company's accounting for deferred tax consequences represents the best estimate of those future events.

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

Refer to Note 11 for additional information on income taxes.

(m) **Revenue Recognition**

The Company adopted Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers ("Topic 606"), effective as of July 1, 2018. Topic 606 requires revenue to be recognized when an entity transfers control of goods or services to a customer in an amount that reflects the consideration to which a company also expects to be entitled to for those goods or services. To achieve this core principle, the Company recognizes revenue from contracts with customers based on the following five steps:

- 1) Identify the contract with a customer;
- 2) Identify the performance obligations in the contract;
- 3) Determine the transaction price;
- 4) Allocate the transaction price to performance obligations in the contract; and
- 5) Recognize revenue when or as the Company satisfies a performance obligation.

The Company derives its revenue from contracts predominantly from recurring and non-recurring service fees. While the majority of its agreements are generally cancellable by the client on 60 days' notice or less, the Company began entering into term arrangements in fiscal 2018, which are generally two years in length. Recurring fees are derived from payroll, timekeeping, and HR-related cloud-based computing services as follows:

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

The majority of the Company's recurring fees are satisfied over time as services are provided. The performance obligations related to payroll services are satisfied upon the processing of the client's payroll with the fee charged and collected based on a per employee per payroll frequency fee. The performance obligations related to time and attendance services and HR related services are satisfied over time each month with the fee charged and collected based on a per employee per month fee. For subscription based fees which can include payroll, time and attendance, and HR related services, the Company recognizes the applicable recurring fees over time each month with the fee charged and collected based on a per employee per month fee.

The Company has certain optional performance obligations that are satisfied at a point in time including the sales of time clocks and W-2 services.

Non-recurring service fees consist mainly of nonrefundable implementation fees, which involve setting the client up in, and loading data into, the Company's cloud-based modules. These implementation activities are considered

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set-up activities. The Company has determined that the nonrefundable upfront fees provide certain clients with a material right to renew the contract. Implementation fees are deferred and amortized generally over a period up to 24 months.

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

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

The following table, consistent with the presentation on the consolidated statements of operations and comprehensive income, disaggregates revenue by recurring fees and implementation services and other, representing the major categories of revenue:

	Year Ended June 30, 2019
Recurring fees	\$ 436,955
Implementation services and other	10,797
Total revenues from contracts	\$ 447,752

Deferred revenue

The timing of revenue recognition for recurring revenue is consistent with the timing of invoicing as they occur simultaneously upon the client payroll-processing period or by month. As such, the Company does not recognize contract assets or liabilities related to recurring revenue.

The nonrefundable upfront fees related to implementation services are invoiced with the client's first payroll period. The Company defers and amortizes these nonrefundable upfront fees generally over a period up to 24 months based on the type of contract. The following table summarizes the changes in deferred revenue (i.e. contract liability) related to these nonrefundable upfront fees as follows:

	Year Ended June 30, 2019
Balance at beginning of the year	\$ —
Deferral of revenue	13,254
Revenue recognized	(6,965)
Balance at end of the year	<u>\$ 6,289</u>

Deferred revenue related to these nonrefundable upfront fees are recorded within accrued expenses and other long-term liabilities on the consolidated balance sheets. The Company expects to recognize these deferred revenue balances of \$4,738 in fiscal 2020, \$1,418 in fiscal 2021, and \$133 thereafter.

Deferred contract costs

The Company defers certain selling and commission costs that meet the capitalization criteria under ASC 340-40, which were expensed as incurred prior to the adoption of Topic 606. The Company also capitalizes certain costs to fulfill a contract related to its proprietary products if they are identifiable, generate or enhance resources used to satisfy future performance obligations and are expected to be recovered under ASC 340-40. As discussed in Note 2(s), the Company determined that implementation services related to its proprietary products are not separate performance obligations for contracts entered into after July 1, 2018. Implementation fees are treated as nonrefundable upfront fees and the related implementation costs are required to be capitalized and amortized over the expected period of benefit, which is the period in which the Company expects to recover the costs and enhance its ability to satisfy future performance obligations.

The Company utilizes the portfolio approach to account for both the cost of obtaining a contract and the cost of fulfilling a contract. These capitalized costs are amortized over the expected period of benefit, which has been determined to be over 7 years based on the Company's average client life and other qualitative factors, including rate of

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technological changes. The Company does not incur any additional costs to obtain or fulfill contracts upon renewal. The Company recognizes additional selling and commission costs and fulfillment costs when an existing client purchases additional services. These additional costs only relate to the additional services purchased and do not relate to the renewal of previous services.

The following tables present the deferred contract costs balances and the related amortization expense for these deferred contract costs:

	For the Year Ended June 30, 2019			
	Beginning	Capitalized		Ending
	Balance	Costs	Amortization	Balance
Costs to obtain a new contract	\$ 68,107	\$ 30,994	\$ (16,998)	\$ 82,103
Costs to fulfill a contract	—	22,739	(1,743)	20,996
Total	\$ 68,107	\$ 53,733	\$ (18,741)	\$ 103,099

Deferred contract costs are recorded within deferred contract costs and long-term deferred contract costs on the consolidated balance sheets. Amortization of deferred contract costs is recorded in Implementation services and other cost of revenue, Sales and marketing, and General and administrative in the consolidated statements of operations and comprehensive income.

Remaining Performance Obligations

The Company has applied the practical expedients as allowed under Topic 606 and elects not to disclose the value of unsatisfied performance obligations for contracts that have an original expected duration of one year or less and contracts for which the variable consideration is allocated entirely to wholly unsatisfied performance obligations. The Company's remaining performance obligations related to minimum monthly fees on its term based contracts was approximately \$43,181 as of June 30, 2019, which will be generally recognized over the next 24 months.

(n) Cost of Revenues

Cost of revenues consists primarily of the cost of recurring revenues and implementation services. Cost of recurring revenues consist primarily of costs to provide recurring services and support to the Company's clients and includes amortization of capitalized internal-use software. The Company expenses these costs when incurred. Cost of implementation services and other consist primarily of costs to provide implementation and other services. Such costs were previously expensed when incurred, but after the adoption of Topic 606 and ASC 340-40, cost of revenues for implementation services for the Company's proprietary products are amortized over a period of 7 years.

(o) Advertising

Advertising costs are expensed as incurred. Advertising costs amounted to \$199, \$179 and \$283 for the years ended June 30, 2017, 2018 and 2019, respectively.

(p) Stock-Based Compensation

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

(q) Commitments and Contingencies

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

(r) *Segment Information*

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

(s) *Recently Adopted Accounting Standards*

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). Topic 606 supersedes a majority of existing revenue recognition guidance under GAAP, and requires companies to recognize revenue when it transfers goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling a contract under Subtopic 340-40, Other Assets and Deferred Costs – Contracts with Customers. The Company adopted the new standard, including subsequent amendments and Subtopic 340-40, effective as of July 1, 2018 using the modified retrospective method of transition, which limited the application of the new standard only to contracts that were not completed as of the effective date. The adoption of Topic 606 did not have a material impact in the timing or amount of revenue recognized. However, it did have a material impact on its consolidated balance sheet due to the deferral of costs of obtaining and fulfilling a contract as detailed below. The Company has updated its control framework for new internal controls and has updated existing controls relating to the new standard.

Under the legacy revenue standard through fiscal 2018, the Company accounted for implementation and recurring services each as a separate unit of account. The Company was able to establish standalone value for implementation services as supported by the activity of third-party resellers and other vendors that performed certain implementation services. The Company observed that third party implementation activity had continued to decrease over time and at the same time, the Company had invested in proprietary modules and processes that impact implementation activities. The Company determined that from July 1, 2018 forward it no longer had a sufficient basis to establish standalone value of implementations for its proprietary products due to the culmination of the changes to the Company's modules and processes that eliminated the ability of third parties to perform implementation services. Similarly, the Company determined that these implementation services are not a separate performance obligation under Topic 606 for contracts entered into after July 1, 2018 and the associated implementation fees are treated as nonrefundable upfront fees which are deferred and amortized over a period of time instead of recognized upon completion. The Company recognized \$2,191, net of deferred taxes, of contract assets for implementation fees related to open contracts as of July 1, 2018, which began when the Company was still able to establish standalone value for implementation activities. This adjustment was recorded through retained earnings (accumulated deficit) in the statement of changes in stockholder's equity upon adoption on July 1, 2018.

The Company also finalized the treatment of costs of obtaining and fulfilling a new contract under the new standard. The Company is now required to defer these costs and amortize them over the expected period of benefit, which it has determined to be 7 years. The Company recognized the cumulative effect related to the deferral of the costs of obtaining new contracts of \$50,481, net of deferred taxes, which was recorded through retained earnings (accumulated deficit) in the statement of changes in stockholder's equity upon adoption on July 1, 2018.

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The cumulative effect of the changes made to the July 1, 2018 balance sheet due to the adoption of Topic 606 were as follows:

	As Reported June 30, 2018	Adjustments due to Topic 606	Balances at July 1, 2018
Balance Sheet			
Assets			
Deferred contract costs	\$ —	\$ 14,783	\$ 14,783
Prepaid expenses and other	11,248	1,730	12,978
Long-term deferred contract costs	—	53,324	53,324
Long-term prepaid expenses and other	1,504	1,226	2,730
Deferred income tax assets, net	22,140	(18,391)	3,749
Stockholders' Equity			
Retained earnings (accumulated deficit)	(6,678)	52,672	45,994

The following table summarizes the impact from the adoption of Topic 606 on the Company's consolidated statements of operations and comprehensive income:

	Year Ended June 30, 2019		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Statement of Operations			
Revenues			
Recurring fees	\$ 436,955	\$ 438,685	\$ (1,730)
Implementation services and other	10,797	4,786	6,011
Cost of Revenues			
Implementation services and other	28,640	49,252	(20,612)
Operating expenses			
Sales and marketing	112,599	126,331	(13,732)
General and administrative	94,630	95,278	(648)
Income tax expense (benefit)	4,223	(5,964)	10,187
Net income	53,823	24,737	29,086

The following table summarizes the impact from the adoption of Topic 606 on the Company's consolidated balance sheet:

	June 30, 2019		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Balance Sheet			
Assets			
Deferred contract costs	\$ 21,677	\$ —	\$ 21,677
Prepaid expenses and other	13,895	12,823	1,072
Long-term deferred contract costs	81,422	—	81,422
Long-term prepaid expenses and other	1,975	1,821	154
Deferred income tax assets, net	6,472	28,107	(21,635)
Liabilities			
Accrued expenses	57,625	54,541	3,084
Other long-term liabilities	1,723	10,818	(9,095)
Deferred income tax liabilities, net	6,943	—	6,943
Stockholders' Equity			
Retained earnings (accumulated deficit)	99,817	18,059	81,758

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The following table summarizes the impact from the adoption of Topic 606 on the Company's consolidated statement of cash flows:

	Year Ended June 30, 2019		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Statement of Cash Flows			
Net income	\$ 53,823	\$ 24,737	\$ 29,086
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income tax expense (benefit)	4,134	(6,053)	10,187
Changes in operating assets and liabilities:			
Deferred contract costs	(34,992)	—	(34,992)
Prepaid expenses and other	389	(1,341)	1,730
Accrued expenses	13,625	19,636	(6,011)
Net cash provided by operating activities	115,032	115,032	—

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash: a consensus of the FASB Emerging Issues Task Force ("ASU 2016-18"), which requires that the statement of cash flows explain the change during a reporting period in total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents. Effective July 1, 2018, the Company adopted ASU 2016-18 on a retrospective basis and now includes funds held for clients' cash and cash equivalents as a component of total cash, cash equivalents and funds held for clients' cash and cash equivalents in the consolidated statement of cash flows. As a result, the Company reclassified certain amounts previously reported on the statement of cash flows for the years ending June 30, 2017 and 2018 to conform to the requirements of the new standard. The adoption of this standard had no impact to the Company's balance sheets, statements of operations and comprehensive income or statements of changes in stockholders' equity.

In March 2018, the FASB issued ASU 2018-05, Income Taxes (Topic 740) ("ASU 2018-05") which incorporates the SEC's Staff Accounting Bulletin 118 ("SAB 118") issued on December 22, 2017. SAB 118 provides for a provisional measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act (the "Tax Act"), not to exceed one year from enactment of the new tax law. Entities are permitted to utilize reasonable estimates until they have finished analyzing the effects of the Tax Act. The Company recognized provisional income tax effects of the Tax Act during fiscal 2018 in accordance with SAB 118, and completed its accounting under the Tax Act in December 2018. Refer to Note 11 for additional information.

(t) *Recently Issued Accounting Standards*

In February 2016, the FASB issued ASU 2016-02, Leases which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use model ("ROU") that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The Company plans to adopt the new standard when it is effective on July 1, 2019 using the modified retrospective method and the transition relief guidance provided by the FASB in ASU 2018-11. Consequently, financial information will not be updated and the disclosures required under the new standard will not be provided for dates and periods before July 1, 2019. The Company plans to elect the package of practical expedients and not reassess prior conclusions on whether contracts are or contain a lease, lease classification, and initial direct costs. In addition, the Company plans to adopt the lessee practical expedient to combine lease and non-lease components for all asset classes. The Company will also elect to not recognize right-of-use assets and lease liabilities for leases with a term of 12 months or less.

While the Company continues to assess all of the effects of adoption, it currently believes the most significant effects relate to (1) the recognition of new ROU assets and lease liabilities on the balance sheet for operating leases; and (2) providing significant new disclosures about leasing activities. Upon adoption, the Company expects to recognize lease liabilities ranging between \$82,000 and \$87,000.

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In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (“ASU 2018-13”), which amends the requirements for fair value measurement disclosures. ASU 2018-13 removes, modifies or adds certain disclosure requirements under GAAP. This standard is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. Any new disclosure requirements must be applied on a prospective basis in the interim and annual periods of initial adoption; all removed or modified requirements must be applied retrospectively to all periods presented. The Company plans to adopt this standard at the effective date and does not expect any material impact from adoption.

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

(3) Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients consist of the following:

Type of Issue	June 30, 2018			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	\$ 137,193	\$ —	\$ —	\$ 137,193
Funds held for clients' cash and cash equivalents	1,102,541	—	(3)	1,102,538
Available-for-sale securities:				
Commercial paper	50,703	3	(4)	50,702
Corporate bonds	37,508	8	(134)	37,382
Asset-backed securities	25,901	1	(55)	25,847
U.S. treasury securities	9,879	—	(2)	9,877
Total available-for-sale securities (1)	123,991	12	(195)	123,808
Total investments	\$ 1,363,725	\$ 12	\$ (198)	\$ 1,363,539

- (1) Included within the fair value of total available-for-sale securities above is \$732 of corporate investments and \$123,076 of funds held for clients.

Type of Issue	June 30, 2019			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	\$ 132,478	\$ —	\$ (2)	\$ 132,476
Funds held for clients' cash and cash equivalents	1,293,673	—	(6)	1,293,667
Available-for-sale securities:				
Commercial paper	63,397	33	(2)	63,428
Corporate bonds	27,044	59	(4)	27,099
Asset-backed securities	26,488	55	(3)	26,540
U.S. treasury securities	13,736	21	-	13,757
Total available-for-sale securities (2)	130,665	168	(9)	130,824
Total investments	\$ 1,556,816	\$ 168	\$ (17)	\$ 1,556,967

- (2) Included within the fair value of total available-for-sale securities above is \$30,022 of corporate investments and \$100,802 of funds held for clients.

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The Company began investing corporate funds in available-for-sale securities during the first quarter of fiscal 2019 and as a result, reclassified \$732 as of June 30, 2018 from Prepaid expenses and other on the consolidated balance sheets to Corporate investments in order to conform to the current year's presentation. Cash and cash equivalents and funds held for clients' cash and cash equivalents included demand deposit accounts, money market funds, commercial paper and short-term U.S. treasury securities as of June 30, 2018 and 2019.

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

	June 30, 2018	June 30, 2019
Cash and cash equivalents	\$ 137,193	\$ 132,476
Corporate investments	732	29,314
Funds held for clients	1,225,614	1,394,469
Long-term prepaid expenses and other	—	708
Total investments	\$ 1,363,539	\$ 1,556,967

Available-for-sale securities that have been in an unrealized loss position for a period of less and greater than 12 months are as follows:

	June 30, 2018					
	Securities in an unrealized loss position for less than 12 months		Securities in an unrealized loss position for greater than 12 months		Total	
	Gross unrealized		Gross unrealized		Gross unrealized	
	losses	Fair value	losses	Fair value	losses	Fair value
Commercial paper	\$ (4)	\$ 23,657	\$ —	\$ —	\$ (4)	\$ 23,657
Corporate bonds	(134)	29,122	—	—	(134)	29,122
Asset-backed securities	(55)	17,960	—	—	(55)	17,960
U.S. treasury securities	(2)	4,933	—	—	(2)	4,933
Total available-for-sale securities	\$ (195)	\$ 75,672	\$ —	\$ —	\$ (195)	\$ 75,672

	June 30, 2019					
	Securities in an unrealized loss position for less than 12 months		Securities in an unrealized loss position for greater than 12 months		Total	
	Gross unrealized		Gross unrealized		Gross unrealized	
	losses	Fair value	losses	Fair value	losses	Fair value
Commercial paper	\$ (2)	\$ 19,055	\$ —	\$ —	\$ (2)	\$ 19,055
Corporate bonds	(1)	1,500	(3)	3,701	(4)	5,201
Asset-backed securities	(1)	386	(2)	2,958	(3)	3,344
Total available-for-sale securities	\$ (4)	\$ 20,941	\$ (5)	\$ 6,659	\$ (9)	\$ 27,600

The Company did not make any material reclassification adjustments out of accumulated other comprehensive income (loss) for realized gains and losses on the sale of available-for-sale securities during the years ended June 30, 2018 or 2019. Gross realized gains and losses on the sale of available-for-sale securities were immaterial for the years ended June 30, 2018 and 2019.

The Company regularly reviews the composition of its portfolio to determine the existence of other-than-temporary-impairment ("OTTI"). The Company did not recognize any OTTI charges in accumulated other comprehensive income (loss) during the years ended June 30, 2018 or 2019, nor does it believe that OTTI exists in its portfolio as of June 30, 2019. The Company plans to retain the securities in an unrealized loss position for a period of time sufficient enough to recover their amortized cost basis or until their maturity date. The Company believes that the unrealized losses on these securities were not due to deterioration in credit risk. The securities in an unrealized loss position held an A-1 rating or better as of June 30, 2019.

Expected maturities of available-for-sale securities at June 30, 2019 are as follows:

	<u>Amortized cost</u>	<u>Fair value</u>
One year or less	\$ 123,116	\$ 123,238
One year to two years	7,549	7,586
Total available-for-sale securities	<u>\$ 130,665</u>	<u>\$ 130,824</u>

(4) Fair Value Measurement

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

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

The Company measures any cash and cash equivalents, accounts receivable, accounts payable and client fund obligations at fair value on a recurring basis using Level 1 inputs. The Company considers the recorded value of these financial assets and liabilities to approximate the fair value of the respective assets and liabilities at June 30, 2018 and June 30, 2019 based upon the short-term nature of these assets and liabilities.

Marketable securities, consisting of securities classified as available-for-sale as well as certain cash equivalents, are recorded at fair value on a recurring basis using Level 2 inputs obtained from an independent pricing service. Available-for-sale securities include commercial paper, corporate bonds, asset-backed securities and US treasury securities. The independent pricing service utilizes a variety of inputs including benchmark yields, broker/dealer quoted prices, reported trades, issuer spreads as well as other available market data. The Company, on a sample basis, validates the pricing from the independent pricing service against another third-party pricing source for reasonableness. The Company has not adjusted any prices obtained by the independent pricing service, as it believes they are appropriately valued. There were no available-for-sale securities classified in Level 3 of the fair value hierarchy at June 30, 2018 or 2019, and the Company did not transfer assets between Levels during the years ended June 30, 2018 or 2019.

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The fair value level for the Company's cash and cash equivalents and available-for-sale securities is as follows:

	June 30, 2018			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 137,193	\$ 137,193	\$ —	\$ —
Funds held for clients' cash and cash equivalents	1,102,538	1,076,414	26,124	—
Available-for-sale securities:				
Commercial paper	50,702	—	50,702	—
Corporate bonds	37,382	—	37,382	—
Asset-backed securities	25,847	—	25,847	—
U.S. treasury securities	9,877	—	9,877	—
Total available-for-sale securities	123,808	—	123,808	—
Total investments	\$ 1,363,539	\$ 1,213,607	\$ 149,932	\$ —

	June 30, 2019			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 132,476	\$ 116,387	\$ 16,089	\$ —
Funds held for clients' cash and cash equivalents	1,293,667	1,244,856	48,811	—
Available-for-sale securities:				
Commercial paper	63,428	—	63,428	—
Corporate bonds	27,099	—	27,099	—
Asset-backed securities	26,540	—	26,540	—
U.S. treasury securities	13,757	—	13,757	—
Total available-for-sale securities	130,824	—	130,824	—
Total investments	\$ 1,556,967	\$ 1,361,243	\$ 195,724	\$ —

(5) Business Combinations

In March 2018, the Company acquired substantially all the assets of BeneFLEX HR Resources, Inc. ("BeneFLEX"), a third party employee benefits administrator, for \$7,658, net of cash and funds held for clients' cash and cash equivalents acquired. BeneFLEX administers employee benefit plans, including flexible spending accounts, health savings accounts, health reimbursement accounts, COBRA, and others. The Company paid \$6,658 upon closing and paid an additional \$1,000 in fiscal 2019 based on BeneFLEX having attained certain revenue targets. This acquisition expanded the portfolio of services available to the Company's clients by allowing it to provide additional benefit administration solutions to its clients, prospects, and broker partners.

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

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

	At March 8, 2018
Goodwill	\$ 3,587
Client relationships	5,550
Non-solicitation agreements	240
Net liabilities assumed	(1,719)
Total purchase price	\$ 7,658

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

(6) Capitalized Internal-Use Software

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

	<u>Year ended June 30,</u>	
	<u>2018</u>	<u>2019</u>
Capitalized internal-use software	\$ 67,678	\$ 90,991
Accumulated amortization	(46,584)	(63,505)
Capitalized internal-use software, net	<u>\$ 21,094</u>	<u>\$ 27,486</u>

Amortization of capitalized internal-use software amounted to \$9,447, \$14,315 and \$16,921 for the years ended June 30, 2017, 2018 and 2019, respectively and is included in Cost of revenues—Recurring revenues.

(7) Property and Equipment

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

	<u>Year ended June 30,</u>	
	<u>2018</u>	<u>2019</u>
Office equipment	\$ 3,743	\$ 4,406
Computer equipment	29,768	36,798
Furniture and fixtures	10,382	11,857
Software	5,965	6,332
Leasehold improvements	36,366	44,350
Time clocks rented by clients	4,534	4,679
Total	<u>90,758</u>	<u>108,422</u>
Accumulated depreciation	(28,729)	(38,366)
Property and equipment, net	<u>\$ 62,029</u>	<u>\$ 70,056</u>

Depreciation expense amounted to \$10,068, \$14,192 and \$15,392 for the years ended June 30, 2017, 2018 and 2019, respectively.

(8) Goodwill and Intangible Assets

There were no changes to goodwill between the year ended June 30, 2018 and June 30, 2019. The Company's amortizable intangible assets and estimated useful lives are as follows:

	<u>June 30,</u> <u>2018</u>	<u>June 30,</u> <u>2019</u>	<u>Useful</u> <u>Life</u>
Client relationships	\$ 18,130	\$ 18,130	7 - 9 years
Non-solicitation agreements	600	600	2 - 4 years
Total	18,730	18,730	
Accumulated amortization	(5,728)	(7,979)	
Intangible assets, net	<u>\$ 13,002</u>	<u>\$ 10,751</u>	

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Amortization expense for acquired intangible assets was \$1,512, \$1,695 and \$2,251 for the years ended June 30, 2017, 2018 and 2019, respectively. Future amortization expense for acquired intangible assets is as follows, as of June 30, 2019:

Year ending June 30,	
2020	\$ 2,251
2021	2,251
2022	2,232
2023	2,118
2024	1,356
Thereafter	543
Total	<u>\$ 10,751</u>

(9) Accrued Expenses

The components of accrued expenses are as follows:

	Year ended June 30,	
	2018	2019
Accrued payroll and personnel costs	\$ 31,206	\$ 39,095
Lease exit obligations	2,143	1,482
Deferred revenue	654	5,572
Other	8,238	11,476
Total accrued expenses	<u>\$ 42,241</u>	<u>\$ 57,625</u>

(10) Leases

The Company primarily leases office space in Illinois, Florida, Idaho and other U.S. states under non-cancellable operating leases expiring on various dates from August 2019 through October 2032. The leases provide for increasing annual base rents and oblige the Company to fund its proportionate share of operating expenses and, in certain cases, real estate taxes. The Company also leases various types of office and production related equipment under non-cancellable operating leases expiring on various dates from July 2019 through July 2024.

In June 2016, the Company entered into a lease for approximately 310 rentable square feet of office space located in Schaumburg, Illinois. The Company currently utilizes the leased premises as its headquarters, relocating from its previous headquarters in Arlington Heights, Illinois in the fourth quarter of fiscal 2018. In connection with relocating to its new headquarters, the Company ceased using approximately 126 rentable square feet of its former headquarters in fiscal 2018 and fiscal 2019 and exited the office space lease prior to the lease's contractual termination. The Company recognized \$2,336 and \$423 in early lease exit costs during the years ended June 30, 2018 and 2019, respectively, that are included in General and administrative expense in its consolidated statements of operations and comprehensive income.

In February 2017, the Company entered into a lease for approximately 62 rentable square feet of office space located in Meridian, Idaho. The Company uses the leased premises to accommodate the continued expansion of its employee base in the western region of the United States. The lease provided for phased delivery and commencement dates and the Company commenced Phase I on July 2, 2018. The Company expects to commence Phase II on February 1, 2020 with the actual commencement date subject to timely delivery of the premises by the landlord. Under the terms of the lease, the Company receives a tenant improvement allowance equal to \$50.00 per rentable square foot and a 3-month rent abatement period for each lease phase. The lease began on the Phase I commencement date (July 2, 2018) and will end on July 31, 2028 with four subsequent five-year renewal options.

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

Balance at June 30, 2018	\$	3,261
Additions		611
Payments		(2,336)
Adjustments		111
Balance at June 30, 2019	\$	<u>1,647</u>

Minimum rent payments under operating leases are recognized on a straight-line basis over the term of the lease including any periods of free rent and future rent increases. Rental expense for operating leases, including amortization of leasehold improvements, was \$8,571, \$12,293 and \$13,698 for the years ended June 30, 2017, 2018 and 2019, respectively.

Future minimum lease payments under non-cancellable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2019 are:

Year ending June 30,	
2020	\$ 10,449
2021	11,150
2022	9,500
2023	8,840
2024	8,838
Later years, through 2032	<u>59,401</u>
Total minimum lease payments	\$ <u>108,178</u>

(11) Income Taxes

(a) *Income Taxes*

Income tax expense (benefit) for the years ended June 30, 2017, 2018 and 2019 consists of the following:

	Year ended June 30,		
	2017	2018	2019
Current taxes			
U.S. federal	\$ —	\$ 294	\$ —
State and local	500	364	90
Deferred taxes:			
U.S. federal	137	(15,167)	5,449
State and local	14	(7,338)	(1,316)
Total income tax expense (benefit)	\$ <u>651</u>	\$ <u>(21,847)</u>	\$ <u>4,223</u>

(b) **Tax Rate Reconciliation**

Income tax expense (benefit) differed from the amounts computed by applying the U.S. federal income tax rate of 34% for the years ended June 30, 2017, and 27.55% for the year ended June 30, 2018 and 21% for the year ended June 30, 2019 to pretax income (loss) as a result of the following:

	Year ended June 30,		
	2017	2018	2019
Income tax expense (benefit) at statutory federal rate	34.0 %	27.6 %	21.0 %
Increase (reduction) in income taxes resulting from:			
Research and development credit, net of federal income tax benefit	(13.9)	(6.6)	(3.0)
Non-deductible expenses	9.3	4.6	1.3
Change in valuation allowance	(18.3)	(136.0)	0.3
Effect of Tax Cuts and Jobs Act	—	51.5	—
Stock-based compensation expense	—	(58.3)	(10.4)
State and local income taxes, net of federal income tax benefit	(2.7)	(13.5)	(2.0)
Other	0.4	0.3	0.1
	<u>8.8 %</u>	<u>(130.4)%</u>	<u>7.3 %</u>

The effective tax rate for the years ended June 30, 2018 and 2019 was (130.4)% and 7.3%, respectively, on pre-tax income of \$16,751 and \$58,046, respectively. The increase in the effective tax rate is primarily due to the increase to pre-tax income and non-recurring \$22,771 benefit resulting from the release of the valuation allowance in fiscal year 2018, partially offset by the reduced federal rate and non-recurring detriment of \$8,626 from tax reform in fiscal year 2018.

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

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at June 30, 2018 and 2019 are presented below.

	Year ended June 30,	
	2018	2019
Deferred tax assets:		
Deferred rent	\$ 1,177	\$ 1,963
Accrued expenses	2,709	4,250
Stock-based compensation	10,833	10,373
Net operating loss carryforwards	10,775	9,980
Federal and state tax credits	7,674	11,977
Intangible assets	271	385
Other	146	94
Total deferred tax assets	33,585	39,022
Valuation allowance	(355)	(502)
Net deferred tax assets	33,230	38,520
Deferred tax liabilities:		
Deferred contract costs	—	(27,116)
Research and development costs	(4,711)	(6,294)
Depreciation	(6,379)	(5,581)
Total deferred tax liabilities	(11,090)	(38,991)
Net deferred tax asset (liability)	<u>\$ 22,140</u>	<u>\$ (471)</u>

Succeeding multiple years of recording a full valuation allowance, the Company concluded in the third quarter of fiscal 2018, that all of the valuation allowance for the Company's U.S. federal deferred tax assets and substantially all state deferred tax assets was no longer needed. This was primarily due to three years' cumulative income through the third quarter of fiscal 2018 and the forecast of future taxable income. At March 31, 2018, based on the evaluation of positive and negative evidence, management believed it was more likely than not that the net deferred tax assets could be realized for all federal and substantially all state purposes. Accordingly, the Company recognized a non-recurring tax benefit of \$22,771 related to the valuation allowance reversal. As of June 30, 2019, the Company continues to maintain a

valuation allowance of \$502 for certain state tax benefits which may not be realized. Such assessment may change in the future as further evidence becomes available.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was signed into law. The Tax Act reduced the U.S. federal corporate income tax rate from 35% to 21%. Following the passage of the Tax Act and in accordance with ASC 740, companies were required to re-measure deferred tax balances using the new enacted tax rates. During fiscal year 2018, the Company recorded a one-time net \$8,626 tax expense to revalue its net deferred tax assets to the newly enacted federal statutory rate. The Company generally expects to benefit from the lower statutory rates provided by the Tax Act.

In December 2017, the staff of the SEC issued guidance under Staff Accounting Bulletin No. 118 (later codified into ASU 2018-05), “Income Tax Accounting Implications of the Tax Cuts and Jobs Act,” allowing taxpayers to record provisional amounts for reasonable estimates when they do not have the necessary information available, prepared or analyzed in reasonable detail to complete their accounting for certain income tax effects of the Tax Act. The SEC also issued rules that would allow for a measurement period of up to one year after the enactment date of the Tax Act to finalize the related tax impacts. The Company’s analysis was completed during the second quarter of fiscal 2019 with no additional adjustments made.

At June 30, 2019, the Company has gross net operating loss carryforwards for federal income tax purposes of approximately \$41,810, of which \$40,018 expire from 2029 to 2038. The Company has gross net operating loss carryforwards for state income tax purposes of approximately \$19,636, of which \$18,435 expire from 2020 to 2039. The remaining \$2,993 federal and state net operating loss carryforwards have an indefinite utilization period. The Company also has gross federal and state research and development tax credit and other state credit carryforwards of approximately \$11,977, which expire between 2020 and 2039.

The Company had no unrecognized tax benefits as of June 30, 2017, 2018 and 2019, respectively.

The Company files income tax returns with the United States federal government and various state jurisdictions. Certain tax years remain open for federal and state tax reporting jurisdictions in which the Company does business due to net operating loss carryforwards and tax credits unutilized from such years or utilized in a period remaining open for audit under normal statute of limitations relating to income tax liabilities. The Company, including its domestic subsidiary, files a consolidated federal income tax return. For years before fiscal year ended June 30, 2016, the Company is no longer subject to U.S. federal examination; however, the Internal Revenue Service (IRS) has the ability to review years prior to fiscal year 2016 to the extent the Company utilized tax attributes carried forward from those prior years. The statute of limitations on state filings is generally three to four years.

(12) Stockholders’ Equity

Common Stock

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

(13) Benefit Plans

(a) *Equity Incentive Plans*

The Company maintains a 2008 Equity Incentive Plan (the “2008 Plan”) and a 2014 Equity Incentive Plan (the “2014 Plan”) pursuant to which the Company has reserved shares of its common stock for issuance to its employees, directors and non-employee third parties. The 2014 Plan serves as the successor to the 2008 Plan and permits the granting of restricted stock units and other equity incentives at the discretion of the compensation committee of the Company’s board of directors. No new awards have been or will be issued under the 2008 Plan since the effective date of the 2014 Plan. Outstanding awards under the 2008 Plan continue to be subject to the terms and conditions of the 2008 Plan. The number of shares of common stock reserved for issuance under the 2014 Plan may increase each calendar year, continuing through and including January 1, 2024. The number of shares added each year may be equal to the lesser of (a) four and five tenths percent (4.5%) of the number of shares of common stock of the Company issued and

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outstanding on the immediately preceding December 31, or (b) an amount determined by the Company’s board of directors. The Company’s board of directors determined that it would not increase the number of shares in reserve for issuance under the 2014 Plan as of January 1, 2019.

As of June 30, 2019, the Company had 13,097 shares allocated to the plans, of which 3,338 shares were subject to outstanding options or awards. Generally, the Company issues previously unissued shares for the exercise of stock options or vesting of awards; however, shares previously subject to 2014 Plan grants or awards that are forfeited or net settled at exercise or release may be reissued to satisfy future issuances.

The following table summarizes the changes in the number of shares available for grant under the Company’s equity incentive plans during the year ended June 30, 2019:

	Number of Shares
Available for grant at July 1, 2018	10,030
RSUs granted	(782)
Shares withheld in settlement of taxes and/or exercise price	395
Forfeitures	192
Shares removed	(76)
Available for grant at June 30, 2019	<u>9,759</u>

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

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

	Year ended June 30,		
	2017	2018	2019
Cost of revenue – recurring	\$ 2,162	\$ 2,830	\$ 3,388
Cost of revenue – implementation services and other	1,357	1,388	1,639
Sales and marketing	6,287	7,295	7,631
Research and development	3,086	3,748	5,325
General and administrative	13,842	15,093	20,782
Total stock-based compensation expense	<u>\$ 26,734</u>	<u>\$ 30,354</u>	<u>\$ 38,765</u>

In addition, the Company capitalized \$1,773, \$2,024 and \$2,760 of stock-based compensation expense in its capitalized internal-use software costs in the years ended June 30, 2017, 2018 and 2019, respectively.

In June 2017, Peter McGrail ceased to serve as the Company’s Chief Financial Officer, but continued to serve as an employee of the Company. In connection with Mr. McGrail’s modified employment arrangement, the compensation committee of the Board of Directors approved modifications to terms of the unvested equity awards granted to Mr. McGrail. Any awards held by Mr. McGrail that were subject to time-based vesting became fully-vested upon his death in August 2017. Additionally, any performance-based restricted stock unit (“PSU”) awards held by Mr. McGrail will continue to vest and settle based upon actual achievement of previously-established performance metrics, with Mr. McGrail receiving a pro-rata share of the PSU awards based on the number of days Mr. McGrail was employed over the vesting period. As a result of these award modifications, the Company recognized \$2,925 in additional stock-based compensation expense for the fiscal year ended June 30, 2017, which was included in General and administrative expense in the Company’s consolidated statements of operations and comprehensive income.

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

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The Company values stock options using the Black-Scholes option-pricing model, which requires the input of subjective assumptions, including the risk-free interest rate, expected life, expected stock price volatility and dividend yield. The risk-free interest rate assumption is based upon observed interest rates for U.S. Treasury securities consistent with the expected term of the Company's employee stock options. The expected life represents the period of time the stock options are expected to be outstanding and is based on the simplified method. Under the simplified method, the expected life of an option is presumed to be the mid-point between the vesting date and the end of the contractual term. As the Company has a limited history of trading as a public company, the Company utilizes the simplified method due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to otherwise estimate the expected life of the stock options. Therefore, the expected volatility is based on historical volatilities for publicly traded stock of comparable companies over the estimated expected life of the stock options. The Company assumed no dividend yield because it does not expect to pay dividends in the near future, which is consistent with the Company's history of not paying dividends.

Stock option activity during the periods indicated is as follows:

	Outstanding Options			Aggregate intrinsic value
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (years)	
Balance at July 1, 2018	1,907	\$ 12.40	5.00	\$ 88,595
Options exercised	(378)	\$ 12.92		
Options forfeited	(4)	\$ 20.78		
Balance at June 30, 2019	1,525	\$ 12.24	3.95	\$ 124,373
Options exercisable at June 30, 2019	1,497	\$ 11.82	3.91	\$ 122,770
Options vested and expected to vest at June 30, 2019	1,524	\$ 12.24	3.95	\$ 124,362

There were no stock options granted during the years ended June 30, 2017, 2018 or 2019. The total intrinsic value of options exercised during the years ended June 30, 2017, 2018 and 2019 was \$20,802, \$34,083 and \$24,920, respectively. At June 30, 2019, total unrecognized compensation cost, net of estimated forfeitures, related to unvested stock options granted under the Plan was immaterial.

The Company may also grant RSUs under the 2014 Plan with terms determined at the discretion of the compensation committee of the Company's board of directors. RSUs generally vest over three or four years following the grant date. Certain RSU awards have time-based vesting conditions while other RSUs vest based on the achievement of certain revenue and Adjusted EBITDA targets in future fiscal years. The following table represents restricted stock unit activity during the year ended June 30, 2019:

	Units	Weighted average grant date fair value
RSU balance at July 1, 2018	1,879	\$ 43.39
RSUs granted	782	\$ 67.13
RSUs vested	(660)	\$ 41.52
RSUs forfeited	(188)	\$ 48.83
RSU balance at June 30, 2019	1,813	\$ 53.78
RSUs expected to vest at June 30, 2019	1,689	\$ 53.67

At June 30, 2019, there was \$36,226 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested restricted stock units granted. That cost is expected to be recognized over a weighted average period of 1.85 years.

The total excess income tax benefits for stock-based compensation arrangements was \$15,130, \$33,443 and \$41,195 for the years ended June 30, 2017, 2018 and 2019, respectively, and were recognized through income tax expense.

(b) Employee Stock Purchase Plan

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

As of June 30, 2019, a total of 995 shares of common stock were reserved for future issuances under the ESPP. The number of shares of common stock reserved for issuance under the ESPP may increase each calendar year, continuing through and including January 1, 2024. The number of shares added each year may be equal to the lesser of (a) 400, (b) seventy-five one hundredths percent (0.75%) of the number of shares of common stock of the Company issued and outstanding on the immediately preceding December 31, or (c) an amount determined by the Company’s board of directors. The Company’s board of directors determined that it would not increase the number of shares in reserve for issuance under the ESPP as of January 1, 2019.

The Company issued a total of 116 shares upon the completion of its six-month offering periods ending November 15, 2018 and May 15, 2019. The Company recorded compensation expense attributable to the ESPP of \$1,263, \$1,331 and \$1,949 for the years ended June 30, 2017, 2018 and 2019, respectively, which is included in the summary of stock-based compensation expense above. The grant date fair value of the ESPP offering periods was estimated using the following weighted average assumptions:

	Year ended June 30,		
	2017	2018	2019
Valuation assumptions:			
Expected dividend yield	0 %	0 %	0 %
Expected volatility	38.9 - 53.4 %	28.3 - 39.1 %	33.5 - 38.6 %
Expected term (years)	0.5	0.5	0.5
Risk-free interest rate	0.28 - 1.02 %	1.02 - 2.10 %	2.10 - 2.48 %

(c) 401(k) Plan

The Company maintains a 401(k) plan with a matching provision that covers all eligible employees. The Company matches 50% of employees’ contributions up to 8% of their gross pay. Contributions were \$3,667, \$4,632 and \$5,693 for the years ended June 30, 2017, 2018 and 2019, respectively.

(14) Commitments and Contingencies

(a) Employment Agreements

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

(b) Litigation

On July 12, 2019, a former employee filed a class and collective action complaint under federal and state law alleging that certain employees of the Company were misclassified as salaried exempt employees. The complaint seeks unpaid overtime and other damages. This claim is still in its earliest stages and the Company is unable to estimate any reasonably possible loss, or range of loss, with respect to these matters. The Company intends to vigorously defend against this lawsuit.

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

(15) Net Income Per Share

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

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

	Year ended June 30,		
	2017	2018	2019
Numerator:			
Net income	\$ 6,718	\$ 38,598	\$ 53,823
Denominator:			
Weighted-average shares used in computing net income per share:			
Basic	51,415	52,425	52,914
Weighted-average effect of potentially dilutive shares:			
Employee stock options, restricted stock units and employee stock purchase plan shares	2,642	2,462	2,500
Diluted	54,057	54,887	55,414
Net income per share:			
Basic	\$ 0.13	\$ 0.74	\$ 1.02
Diluted	\$ 0.12	\$ 0.70	\$ 0.97

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

	Year ended June 30,		
	2017	2018	2019
Employee stock options	145	—	—
Restricted stock units	627	92	69
Employee stock purchase plan shares	14	—	13
Total	786	92	82

In August 2018, the Company announced that its board of directors approved a program to repurchase up to \$35,000 of the Company's common stock, with authorization through August 14, 2019. During the first quarter of fiscal 2019, the Company completed the repurchase program and repurchased 442 shares for \$34,991. All shares of common stock repurchased were retired.

(16) Selected Quarterly Financial Data (unaudited)

The following tables set forth selected unaudited quarterly statements of operations data for the years ended June 30, 2018 and 2019.

	Quarter Ended			
	September 30, 2017	December 31, 2017	March 31, 2018	June 30, 2018
Consolidated Statements of Operations Data				
Revenues	\$ 81,500	\$ 86,004	\$ 113,407	\$ 96,616
Gross profit	\$ 46,541	\$ 49,164	\$ 74,755	\$ 57,870
Operating income (loss)	\$ 515	\$ 133	\$ 20,465	\$ (5,164)
Net income (loss)	\$ 543	\$ 431	\$ 39,177	\$ (1,553)
Net income (loss) per share:				
Basic	\$ 0.01	\$ 0.01	\$ 0.74	\$ (0.03)
Diluted	\$ 0.01	\$ 0.01	\$ 0.71	\$ (0.03)
Weighted-average shares used in computing net income (loss) per share:				
Basic	51,893	52,502	52,615	52,699
Diluted	54,610	54,818	55,030	52,699

	Quarter Ended			
	September 30, 2018	December 31, 2018	March 31, 2019	June 30, 2019
Consolidated Statements of Operations Data				
Revenues	\$ 100,504	\$ 107,204	\$ 139,552	\$ 120,373
Gross profit	\$ 64,562	\$ 69,134	\$ 99,807	\$ 80,279
Operating income	\$ 3,776	\$ 7,027	\$ 36,212	\$ 9,209
Net income	\$ 9,852	\$ 5,704	\$ 28,026	\$ 10,241
Net income per share:				
Basic	\$ 0.19	\$ 0.11	\$ 0.53	\$ 0.19
Diluted	\$ 0.18	\$ 0.10	\$ 0.51	\$ 0.18
Weighted-average shares used in computing net income per share:				
Basic	52,865	52,842	52,934	53,017
Diluted	55,487	55,081	55,465	55,692

(17) Subsequent Events

In July 2019, the Company entered into a five-year revolving credit agreement with PNC Bank, National Association and other lenders, which is secured by substantially all of the Company's assets, subject to certain restrictions. The revolving credit agreement provides for a senior revolving credit facility, under which the Company may borrow up to \$250,000, which may be increased to up to \$375,000, subject to obtaining additional lender commitments and satisfying other requirements. The revolving credit facility is scheduled to mature in July 2024, and no amounts have been drawn to date.

Borrowings under the senior revolving credit facility will generally bear interest, at the Company's option, at a rate per annum determined by reference to either the London Interbank Offered Rate ("LIBOR") (or a replacement index for the LIBOR rate) or an adjusted base rate, in each case plus an applicable margin ranging from 0.875% to 1.375% and 0.0% to 0.375%, respectively, based on the then-applicable net senior secured leverage ratio. In addition, the Company is required to pay certain fees, including (i) a quarterly commitment fee at a rate ranging from 0.10% to 0.175% per annum on the daily amount of the undrawn portion of the revolving commitments under the Facility, based on the then-applicable net senior secured leverage ratio, and (ii) a letter of credit fronting fee at a rate of 0.125% per annum on the daily amount available to be drawn under each letter of credit and a letter of credit participation fees at a rate ranging from 0.875% to 1.375% per annum on the daily undrawn amount of all outstanding letters of credit and unreimbursed disbursements relating to letters of credit, based on the then-applicable net senior secured leverage ratio.

The proceeds from any borrowings under the revolving credit facility are to be used to fund working capital, capital expenditures and general corporate purposes, including permitted acquisitions, permitted investments, permitted distributions and share repurchases.

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The Company may generally borrow, prepay and reborrow under the revolving credit facility and terminate or reduce the lenders' commitments at any time prior to revolving credit facility expiration without a premium or a penalty, other than customary "breakage" costs with respect to LIBOR revolving loans.

Under the revolving credit agreement, the Company is required to maintain a maximum net total leverage ratio of not greater than 4.00 to 1.00, a maximum net senior secured leverage ratio of not greater than 3.50 to 1.00 and a minimum interest coverage ratio of not less than 3.00 to 1.00. Additionally, the revolving credit agreement contains customary affirmative and negative covenants, including covenants limiting the ability of the Company to, among other things, grant liens, incur or guaranty debt, effect certain mergers, make investments, dispose of assets, enter into certain transactions, including swap agreements, pay dividends or distributions on their capital stock, make changes in fiscal year or organizational documents, grant negative pledges and enter into transactions with affiliates, in each case subject to customary exceptions for similar credit facilities.

Consent of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Paylocity Holding Corporation:

We consent to the incorporation by reference in the registration statements (No. 333-194840, No. 333-201983, No. 333-209520, No. 333-216001, and No. 333-222959) on Form S-8 of Paylocity Holding Corporation and subsidiaries (the Company) of our report dated August 9, 2019, with respect to the consolidated balance sheets of the Company as of June 30, 2018 and 2019, the related consolidated statements of operations and comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2019, and the related notes (collectively, the consolidated financial statements), and the effectiveness of internal control over financial reporting as of June 30, 2019, which report appears in the June 30, 2019 annual report on Form 10-K of Paylocity Holding Corporation.

Our report on the consolidated financial statements refers to a change in method of accounting for revenues and related costs as a result of the adoption of Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers*.

/s/ KPMG LLP

Chicago, Illinois
August 9, 2019

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO
SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002**

I, Toby J. Williams, certify that:

1. I have reviewed this annual report on Form 10-K of Paylocity Holding Corporation (the "Company") for the year ended June 30, 2019;
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 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 fiscal year ended June 30, 2019 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 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 9, 2019

/s/ Toby J. Williams
Name: Toby J. Williams
Title: Chief Financial Officer (Principal Financial Officer)

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

The undersigned, the Chief Financial Officer of Paylocity Holding Corporation (the "Company"), does hereby certify under the standards set forth and solely for the purposes of 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report on Form 10-K of the Company for the year ended June 30, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in that Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 9, 2019

/s/ Toby J. Williams

Name: Toby J. Williams
Title: Chief Financial Officer (Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
