WAGEWORKS, INC.
Form 10-Q
May 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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: 001-35232

WAGEWORKS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	94-3351864
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

San Mateo, California 1100 Park Place, 4th Floor San Mateo, California	94403
(Address of principal executive offices	(Zip Code)

(650) 577-5200

(Registrant's telephone number, including area code)

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 ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of April 30, 2015, there were 35,735,388 shares of the registrant’s common stock outstanding.

WAGEWORKS, INC.

FORM 10-Q QUARTERLY REPORT

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WAGEWORKS, INC.

Consolidated Balance Sheets

(In thousands, except per share amounts)

	December 31, 2014 Derived from Audited Financial Statements	March 31, 2015 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 413,301	$ 451,842
Restricted cash	332	332
Accounts receivable, net	54,453	62,597
Deferred tax assets - current	11,006	11,006
Prepaid expenses and other current assets	14,215	17,290
Total current assets	493,307	543,067
Property and equipment, net	39,137	41,480
Goodwill	157,109	157,109
Acquired intangible assets, net	94,776	94,144
Deferred tax assets	699	699
Other assets	9,687	6,344
Total assets	$ 794,715	$ 842,843
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 54,285	$ 49,501
Customer obligations	362,451	399,725
Short-term contingent payment	3,180	3,940
Other current liabilities	11,924	11,444

Total current liabilities	431,840	464,610
Long-term debt	79,219	79,256
Long-term contingent payment, net of current portion	695	—
Other non-current liability	3,537	3,681
Total liabilities	515,291	547,547
Stockholders' Equity:		
Common stock, $0.001 par value. Authorized 1,000,000 shares; issued 35,479 shares at December 31, 2014 and 35,725 shares at March 31, 2015	36	36
Additional paid-in capital	303,568	313,801
Accumulated deficit	(24,180)	(18,541)
Total stockholders’ equity	279,424	295,296
Total liabilities and stockholders’ equity	$ 794,715	$ 842,843

The accompanying notes are an integral part of the consolidated financial statements.

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WAGEWORKS, INC.

Consolidated Statements of Income

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	2014	2015
Revenues:		
Healthcare	$ 39,984	$ 47,289
Commuter	16,043	15,897
COBRA	4,038	12,570
Other	2,555	9,540
Total revenue	62,620	85,296
Operating expenses:		
Cost of revenues (excluding amortization of internal use software)	22,797	32,071
Technology and development	5,199	10,585
Sales and marketing	9,367	13,131
General and administrative	9,932	13,565
Amortization and change in contingent consideration	4,420	6,279
Total operating expenses	51,715	75,631
Income from operations	10,905	9,665
Other income (expense):		
Interest income	1	2
Interest expense	(257)	(575)
Other income	13	66
Income before income taxes	10,662	9,158
Income tax provision	(4,218)	(3,519)
Net income	$ 6,444	$ 5,639
Basic net income per share	$ 0.19	$ 0.16

Diluted net income per share	$ 0.18	$ 0.15
Shares used in basic net income per share calculations	34,831	35,555
Shares used in diluted net income per share calculations	36,303	36,668

The accompanying notes are an integral part of the consolidated financial statements.

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WAGEWORKS, INC.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2014	2015
Cash flows from operating activities:		
Net income	$ 6,444	$ 5,639
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	777	1,554
Amortization and change in contingent consideration	4,420	6,279
Stock-based compensation	2,038	4,436
Loss on disposal of fixed assets	—	4
Provision for doubtful accounts	94	44
Deferred taxes	3,284	2,120
Excess tax benefit from the exercise of stock options	(4,213)	(3,519)
Changes in operating assets and liabilities:		
Accounts receivable	(18,492)	(8,188)
Prepaid expenses and other current assets	258	(2,791)
Other assets	(2,376)	200
Accounts payable and accrued expenses	(8,734)	(5,835)
Customer obligations	6,282	37,274
Other liabilities	(577)	813
Net cash provided by (used in) operating activities	(10,795)	38,030
Cash flows from investing activities:		
Purchases of property and equipment	(3,233)	(5,972)
Net cash used in investing activities	(3,233)	(5,972)
Cash flows from financing activities:		
Proceeds from exercise of common stock options	2,495	2,366
Proceeds from issuance of common stock (Employee Stock Purchase Plan)	702	598
Excess tax benefit from the exercise of stock options	4,213	3,519
Net cash provided by financing activities	7,410	6,483
Net increase (decrease) in cash and cash equivalents	(6,618)	38,541
Cash and cash equivalents at beginning of period	359,958	413,301

Cash and cash equivalents at end of period	$ 353,340	$ 451,842
Supplemental cash flow disclosure:		
Cash paid during the period for:		
Interest	$ 444	$ 1,053
Taxes	25	317

The accompanying notes are an integral part of the consolidated financial statements.

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(1) Summary of Business and Significant Accounting Policies

Business

WageWorks, Inc., or the Company, is a leader in administering Consumer-Directed Benefits, or CDBs, which empower employees to save money on taxes while also providing corporate tax advantages for employers. The Company is solely dedicated to administering CDBs, including pre-tax spending accounts such as health and dependent care Flexible Spending Accounts, or FSAs, Health Savings Accounts, or HSAs, Health Reimbursement Arrangements, or HRAs, as well as commuter benefit services, including transit and parking programs, wellness programs, COBRA and other employee spending account benefits, in the United States.

The Company delivers its CDB programs through a highly scalable delivery model that employer clients and their employee participants may access through a standard web browser on any internet-enabled device, including computers, smart phones and other mobile devices such as tablet computers. The Company's on-demand delivery model eliminates the need for its employer clients to install and maintain hardware and software in order to support CDB programs and enables the Company to rapidly implement product enhancements across the Company's entire user base.

The Company's CDB programs assist employees and their families in saving money by using pre-tax dollars to pay for certain of their healthcare, dependent care and commuter expenses. Employers financially benefit from the Company's programs through reduced payroll taxes, even after factoring in the Company's fees. Under the Company's FSA, HSA and commuter programs, employee participants contribute funds from their pre-tax income to pay for qualified out-of-pocket healthcare expenses not fully covered by insurance, such as co-pays, deductibles and over-the-counter medical products or for commuting costs. Under the Company's HRA programs, employer clients provide their employee participants with a specified amount of available reimbursement funds to help their employee participants defray out-of-pocket medical expenses such as deductibles, co-insurance and co-payments. All amounts paid by the employer into HRAs are deductible by the employer as an ordinary business expense and are tax-free to the employee.

The Company operates as a single reportable segment on an entity level basis. The Company generates revenue from the administration of healthcare, commuter, COBRA and other employer sponsored tax-advantaged benefit services. The entity level is the aggregation of these four revenue streams.

Unaudited Interim Financial Statements

In the opinion of the Company's management, the unaudited interim consolidated financial statements and condensed notes have been prepared on the same basis as the audited consolidated financial statements and reflect all adjustments that, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented in accordance with accounting principles generally accepted in the United States of America (GAAP). The results of the interim period presented herein are not necessarily indicative of the results of future periods or annual results for the year ending December 31, 2015.

These unaudited interim consolidated financial statements and condensed notes should be read in conjunction with the December 31, 2014 audited financial statements and related notes, together with management's discussion and analysis of financial condition and results of operations, included in the Company's Annual Report on Form 10-K. The December 31, 2014 consolidated balance sheet included in this interim Quarterly Report on Form 10-Q was derived from audited financial statements.

There have been no changes in the Company's significant accounting policies from those that were disclosed in the Company's audited consolidated financial statements for the fiscal year ended December 31, 2014 included in the Company's Annual Report on Form 10-K.

Principles of Consolidation

The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Acquisitions of businesses are accounted for as business combinations, and accordingly, the results of operations of acquired businesses are included in the consolidated financial statements from the date of acquisition. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. 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 financial

statements and the reported amounts of revenue and expenses during the reporting period. Significant estimates in these consolidated financial statements include allowances for doubtful accounts, estimates of future cash flows associated with assets, asset impairments, useful lives for depreciation and amortization, loss contingencies, expired and unredeemed products, deferred tax assets, reserve for income tax uncertainties, the assumptions used for stock-based compensation, the assumptions used for software and web site development cost classification, and the assumptions used to fair value contingent consideration associated with acquisitions and purchase accounting. Actual results could differ from those estimates. In making its estimates, the Company considers the current economic and legislative environment in the estimates and has considered those factors when reviewing the assumptions and estimates.

Fair Value of Financial Instruments

Financial Accounting Standards Board (FASB) ASC 820, Fair Value Measurements and Disclosures, or ASC 820, provides a consistent framework to define, measure, and disclose the fair value of assets and liabilities in financial statements. ASC 820 establishes a three-level hierarchy priority for disclosure of assets and liabilities recorded at fair value. The ordering of priority reflects the degree to which objective prices in external active markets are available to measure fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable.

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.
- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

The contingent consideration payables related to the acquisitions of Benefit Concepts, Inc. (BCI) and Crosby Benefit Systems, Inc. (CBS), are recorded at fair value on the acquisition date and are adjusted quarterly to fair value. The increases or decreases in the fair value of contingent consideration payable can result from changes in anticipated revenue levels and changes in assumed discount periods and rates. As the fair value measure is based on significant inputs that are not observable in the market, it is categorized as Level 3.

Other financial instruments not measured at fair value on the Company's unaudited consolidated balance sheet at March 31, 2015, but which require disclosure of their fair values include: cash and cash equivalents (including restricted cash), accounts receivable, accounts payable and accrued expenses and debt under the line of credit with MUFG Union Bank, N.A. (formerly Union Bank, N.A.) The estimated fair value of such instruments at March 31, 2015 approximates their carrying value as reported on the consolidated balance sheet. The fair value of all of these instruments are categorized as Level 2 of the fair value hierarchy, with the exception of cash and cash equivalents, which is categorized as Level 1 due to its short term nature.

The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis that used significant unobservable inputs (Level 3) (dollars in thousands):

	Contingent Consideration BCI	Contingent Consideration CBS
Balances at December 31, 2014	2,705	1,170
Gains or losses included in earnings:		
Losses on revaluation of contingent consideration	46	19
Balances at March 31, 2015	$ 2,751	$ 1,189

The Company measures contingent consideration elements each reporting period at fair value and recognizes changes in fair value in earnings each period in the amortization and change in contingent consideration line item on the consolidated statements of income, until the contingency is resolved.

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The Company recorded a $0.1 million charge related to the change in fair value of the contingent considerations for BCI and CBS, for both the three months ended March 31, 2014 and 2015, as a result of accretion charges due to the passage of time.

Quantitative Information about Level 3 Fair Value Measurements

The significant unobservable inputs used in the fair value measurement of the Company's contingent consideration designated as Level 3 are as follows:

	Fair Value at March 31, 2015 (in thousands)	Valuation Technique	Significant Unobservable Input
Contingent consideration - BCI	$2,751	Discounted cash flow	Annualized revenue and probability of achievement
Contingent consideration - CBS	$1,189	Discounted cash flow	Annualized revenue and probability of achievement

Sensitivity to Changes in Significant Unobservable Inputs

As presented in the table above, the significant unobservable inputs used in the fair value measurement of contingent consideration related to the acquisitions are annualized revenue forecasts developed by the Company's management and the probability of achievement of those revenue forecasts. Significant increases (decreases) in these unobservable inputs in isolation would result in a significantly lower (higher) fair value measurement.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, or ASU 2014-09, which clarifies existing accounting literature relating to how and when a company recognizes revenue. Under ASU 2014-09, a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services. Additionally, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard allows for either a full retrospective or a modified retrospective transition method. The FASB tentatively decided on April 1, 2015 to defer for one year the effective date of the new revenue standard for public and nonpublic entities reporting under U.S. GAAP. The FASB also tentatively decided to permit entities to early adopt the standard. The tentative decisions will be exposed in an upcoming proposed Accounting Standards Update (ASU) with a 30-day comment period. The Company is in the process of determining what impact, if any, the adoption of this ASU will have on its consolidated financial statements and related disclosures.

(2) Net Income per Share

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended March 31,	
	2014	2015
Numerator (basic and diluted):		
Net income	$ 6,444	$ 5,639
Denominator (basic):		
Weighted average common shares outstanding	34,831	35,555
Denominator (diluted):		
Weighted average common shares outstanding	34,831	35,555
Dilutive stock options	1,472	1,113
Diluted weighted average common shares outstanding	36,303	36,668
Net income per share:		
Basic	$ 0.19	$ 0.16
Diluted	$ 0.18	$ 0.15

Diluted net income per share does not include the effect of the following anti-dilutive common equivalent shares (in thousands):

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	Three Months Ended March 31,	
	2014	2015
Stock options outstanding	47	326

(3) Acquisitions and Channel Partner Arrangement

Ceridian Channel Partner Arrangement

In July 2013, the Company entered into a channel partner arrangement with Ceridian Corporation, or Ceridian, a global product and services company. Pursuant to the arrangement, Ceridian's CDB account administration business was transitioned to the Company as of January 2015. In conjunction with the transition, the Company also entered into a separate reseller arrangement with Ceridian.

CONEXIS Acquisition

On August 1, 2014, the Company entered into an Asset Purchase Agreement with CONEXIS Benefits Administrators, LP ("CONEXIS"), a Texas limited partnership and Word & Brown Insurance Administrator, Inc., a California corporation, pursuant to which the Company acquired substantially all of the assets of CONEXIS. CONEXIS is a leader in employee benefits administration and serves approximately 16,000 organizations of all sizes. This acquisition added a new base of Consumer-Directed Benefits customers and participant relationships. The purchase price was $118.0 million, adjusted for working capital adjustments, of which $108.0 million was paid at closing with the remaining balance classified in the consolidated balance sheet in the other current liabilities line item. The remaining balance is expected to be paid on August 1, 2015 after adjustment for any indemnification losses incurred by the Company for which it is entitled to recover.

The Company accounted for the acquisition of CONEXIS as a purchase of a business under ASC 805. The results of operations for CONEXIS have been included in the Company's financial results since the acquisition.

As part of the purchase price allocation, the Company determined that CONEXIS's separately identifiable intangible assets were its customer relationships, developed technology and trade name. The Company used the income approach to value the customer relationships and trade name. This approach calculates fair value by discounting the after-tax cash flows back to a present value. The baseline data for this analysis was the cash flow estimates used to price the transaction. Cash flows were forecasted and then discounted using a discount rate for customer relationships of 15% and trade name of 12%, based on the estimated IRR and weighted average cost of capital, which employs an estimate of the required equity rate of return and after-tax cost of debt. The Company used a replacement cost approach to estimate the fair value of developed technology in which estimates of development time and cost per man month are used to calculate total replacement cost.

Goodwill was calculated as the difference between the acquisition-date fair value of the consideration transferred and the values assigned to the assets acquired and liabilities assumed. The recognized amount of goodwill is provisional and subject to change pending the completion of the allocation of the consideration transferred to the assets acquired and liabilities assumed. Goodwill recognized from the transaction results from the acquired workforce, the opportunity to expand our client base and achieve greater long-term growth opportunities than either company had operating alone. All of the recognized goodwill is expected to be deductible for tax purposes.

The following table summarizes the allocation of the purchase price at the date of acquisition (in millions):

	Amount	Weighted Average Useful Life (in years)
Other net tangible assets acquired	$ 4.7	
Customer relationships	48.1	10
Developed technology	3.9	5
Trade name	1.6	3
Non-compete agreement	0.2	7
Goodwill	59.5	
Total allocation of acquisition costs	$ 118.0	

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The valuation of certain software licenses, deferred costs and other immaterial working capital balances are provisional and are based on the information that was available as of the acquisition date to estimate the fair value of the assets acquired. The Company believes that information provides a reasonable basis for estimating the fair value but the Company is waiting for additional information necessary to finalize those amounts. Thus, the provisional measurements of fair value reflected are subject to change. Such changes are not expected to be significant. These adjustments to our tangible assets will have an impact on our overall valuation of CONEXIS and in turn may impact the amounts currently recognized for intangible assets and goodwill. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the acquisition date.

(4) Intangible Assets

Acquired intangible assets at December 31, 2014 and March 31, 2015 were comprised of the following (dollars in thousands):

	December 31, 2014			March 31, 2015		
	Gross carrying amount	Accumulated amortization	Net	Gross carrying amount	Accumulated amortization	Net
Amortizable intangible assets:						
Client contracts and broker relationships	$ 120,723	$ 33,885	$ 86,838	$ 123,865	$ 36,924	$ 86,941
Trade names	3,880	1,657	2,223	3,880	1,845	2,035
Technology	13,846	9,390	4,456	13,846	9,895	3,951
Noncompete agreements	2,232	1,798	434	2,232	1,816	416
Favorable lease	1,137	312	825	1,137	336	801
Total	$ 141,818	$ 47,042	$ 94,776	$ 144,960	$ 50,816	$ 94,144

Amortization expense for acquired intangible assets totaled $2.2 million and $3.8 million for the three months ended March 31, 2014 and 2015, respectively.

The estimated expected amortization expense in future periods is as follows (dollars in thousands):

Remainder of 2015	$ 11,232
2016	13,995
2017	13,440
2018	12,814
2019	12,254
Thereafter	30,409
Total	$ 94,144

(5) Accounts Receivable

Accounts receivable at December 31, 2014 and March 31, 2015 were comprised of the following (dollars in thousands):

	December 31, 2014	March 31, 2015
Trade receivables	$ 35,762	$ 41,127
Unpaid amounts for benefit services	19,458	22,290
	55,220	63,417
Less allowance for doubtful accounts	(767)	(820)
Accounts receivable, net	$ 54,453	$ 62,597

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(6) Property and Equipment

Property and equipment at December 31, 2014 and March 31, 2015 were comprised of the following (dollars in thousands):

	December 31, 2014	March 31, 2015
Computers and equipment	$ 13,670	$ 14,620
Software and software development costs	77,104	82,083
Furniture and fixtures	3,306	3,293
Leasehold improvements	8,285	8,298
	$ 102,365	$ 108,294
Less accumulated depreciation and amortization	(63,228)	(66,814)
Property and equipment, net	$ 39,137	$ 41,480

In the three months ended March 31, 2015, the Company capitalized software development costs of $4.7 million. In the three months ended March 31, 2014 and 2015, the Company amortized $2.1 million and $2.4 million of capitalized software development costs, respectively. These costs are included in amortization and change in contingent consideration in the accompanying consolidated statements of income. At March 31, 2015, the unamortized software development costs included in property and equipment in the accompanying consolidated balance sheet was $26.0 million.

Total depreciation expense, including amortization of capitalized software development costs, in the three months ended March 31, 2014 and 2015 was $2.9 million and $4.0 million, respectively.

(7) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses at December 31, 2014 and March 31, 2015 were comprised of the following (dollars in thousands):

	December 31, 2014	March 31, 2015
Accounts payable	$ 1,180	$ 3,515
Payable to benefit providers and transit agencies	19,500	18,510
Accrued payables	11,099	8,511
Accrued compensation and related benefits	16,045	12,009
Other accrued expenses	3,156	2,321
Deferred revenue	3,305	4,635
Accounts payable and accrued expenses	$ 54,285	$ 49,501

(8) Employee Benefit Plans

Employee Stock Option Plan

The Company's stock option program is a long-term retention program that is intended to attract, retain, and provide incentives for talented employees, officers, and directors, and to align stockholder and employee interests. The Company considers its option program critical to its operation and productivity.

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The following table summarizes the weighted-average fair value of stock options granted during the period:

	Three Months Ended March 31,	
	2014	2015
Stock options granted (in thousands)	210	37
Weighted average fair value at date of grant	$ 27.00	$ 24.05

Stock option activity for the three months ended March 31, 2015 is as follows (shares in thousands):

	Shares	Weighted average exercise price	Remaining contractual term (years)	Aggregate intrinsic value (dollars in thousands)
Outstanding at December 31, 2014	3,206	$ 20.90	6.75	$ 140,029
Granted	37	61.08		
Exercised	(214)	11.04		
Forfeited	(16)	28.20		
Outstanding as of March 31, 2015	3,013	$ 22.05	6.74	$ 95,509
Vested and expected to vest at March 31, 2015	2,914	$ 21.53	6.67	$ 93,843
Exercisable at March 31, 2015	1,780	$ 11.48	5.31	$ 74,683

As of March 31, 2015, there was $17.2 million of total unrecognized compensation cost related to unvested stock options which are expected to vest. The cost is expected to be recognized over a weighted average period of approximately 2.8 years as of March 31, 2015.

The weighted average assumptions used in the Black-Scholes option pricing model to value option grants during the three months ended March 31, 2014 and 2015 were as follows:

	Three Months Ended March 31,	
	2014	2015
Expected volatility	47.37%	44.32%
Risk-free interest rate	1.91%	1.55%
Expected term (in years)	6.07	4.74
Dividend yield	—%	—%

Stock-based compensation cost is measured at the grant date based on the fair value of the award. The determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. Expected volatility is determined using weighted average volatility of peer publicly traded companies as well as the Company's own historical volatility. The Company expects that it will increase weighting of its own historical data in future periods, as that history grows over time. The risk-free interest rate is determined by using published zero coupon rates on treasury notes for each grant date given the expected term of the options. The dividend yield of zero is based on the fact that the Company expects to invest cash in operations and has never paid cash dividends on common stock. The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as evidenced by changes to the terms of its stock-based awards.

Restricted Stock Units

The Company grants restricted stock units to certain employees, officers, and directors under the 2010 Equity Incentive Plan. Restricted stock units vest upon performance-based, market-based or service-based criteria.

Performance-based restricted stock units vest based on the satisfaction of specific performance criteria. At each vesting date, the holder of the award is issued shares of the Company’s common stock. Compensation expense from these awards is equal to the fair market value of the Company’s common stock on the date of grant and is recognized over the remaining service period based on the probable outcome of achievement of the financial metrics. Management’s estimate of the number of shares expected to vest is based on the anticipated achievement of the specified performance criteria.

Market-based performance restricted stock units are granted such that they vest upon the achievement of certain per share price targets of the Company’s common stock during a specified performance period. The fair market values of market-based performance restricted stock units are determined using the Monte Carlo simulation method. The Monte Carlo simulation method is subject to variability as several factors utilized must be estimated including the future daily stock price of the Company's common stock over the specified performance period, the Company's stock price volatility and risk-free interest rate. The amount of compensation expense is equal to the per share fair value calculated under the Monte Carlo simulation multiplied by the number of market-based performance restricted stock units granted, recognized over the specified performance period.

Generally, service-based restricted stock units vest over four years with 25% vesting after one year and the balance vesting monthly over the remaining period. Compensation expense is recognized over the requisite service period.

In the first quarter of 2014, the Company granted a total of 106,500 performance-based restricted stock units to certain executive officers and employees. Performance-based restricted stock units are typically granted such that they vest upon the achievement of certain revenue growth rates, and other financial metrics, during a specified performance period for which participants have the ability to receive up to 150% of the target number of shares originally granted.

In the first quarter of 2015, the Company granted a total of 140,000 performance-based restricted stock units to certain executive officers. Performance-based restricted stock units are typically granted such that they vest upon the achievement of certain revenue growth rates, and other financial metrics, during a specified performance period for which participants have the ability to receive up to 150% of the target number of shares originally granted.

The restricted stock units will be eligible to vest based on the Company's achievement against an average annual EBITDA margin target equal to or greater than 22% and compound revenue growth target for the specified performance period.

The following table describes the levels of revenue growth target for the specified performance period for the restricted stock units to vest:

Achievement of Revenue Growth Objective	Percentage of RSU Vesting
20% and Greater	150% will vest
Between 15% but less than 20%	Between 100% and 150% will vest
Between 10% but less than 15%	Between 50% and 100% will vest
Below 10%	None will vest

In the second quarter of 2014, the Company granted a total of 199,000 market-based performance restricted stock units to certain executive officers. The number of shares to be vested is subject to change based on certain market conditions. In the third quarter of 2014, one of the executives notified the Company he would resign and 33,000 market-based performance restricted stock units were forfeited and canceled.

The market-based performance restricted stock units will be eligible to vest based on the Company's achievement of certain per share price of its common stock as reported on the New York Stock Exchange, or NYSE, for any twenty consecutive trading day period during the specified performance period.

The following table describes the price per share targets that must be achieved for the specified performance period for the restricted stock units to vest:

WageWorks Per Share Price on NYSE	Payout Percentage
$100	200%
$90	100%
$75	50%
Below $75	0%

Stock-based compensation expense related to restricted stock units was $0.8 million and $2.6 million for the three months ended March 31, 2014 and 2015, respectively. As of March 31, 2015, there was $26.1 million of total unrecognized compensation cost related to unvested restricted stock units which are expected to vest. The cost is expected to be recognized over a weighted average period of approximately 2.0 years as March 31, 2015.

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The following table summarizes information about restricted stock units issued to officers, directors, and employees under our 2010 Plan:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2014	637	$ 37.99
Granted	190	61.10
Vested	(32)	23.76
Forfeitures	(8)	23.76
Unvested at March 31, 2015	787	$ 44.27

Stock-based compensation is classified in the consolidated statements of income in the same expense line items as cash compensation. None of the stock-compensation cost was capitalized as amounts were immaterial. Amounts recorded as expense in the consolidated statements of income are as follows (in thousands):

	Three Months Ended March 31,	
	2014	2015
Cost of revenue	$ 232	$ 801
Technology and development	208	48
Sales and marketing	329	664

General and administrative	1,269	2,923
Total	$ 2,038	$ 4,436

(9) Income Taxes

The income tax provision for the three months ended March 31, 2014 and 2015 was $4.2 million and $3.5 million, respectively. The Company provides for income taxes using an asset and liability approach, under which deferred income taxes are provided based upon enacted tax laws and rates applicable to periods in which the taxes become payable.

The Company is subject to income taxes in the U.S. federal and various state jurisdictions. Presently, there are no income tax examinations going on in the jurisdictions where the Company operates.

As of March 31, 2015, the Company remains in a net deferred tax asset position. The realization of the Company's deferred tax assets depends primarily on its ability to generate sufficient U.S. taxable income in future periods. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters as management reevaluates the underlying basis for the estimates of future domestic taxable income.

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(10) Commitments and Contingencies

(a) Operating Leases

The Company leases office space and equipment under noncancelable operating leases with various expiration dates through 2023. Future minimum lease payments under noncancelable operating leases are as follows (dollars in thousands):

	Operating leases As of March 31, 2015
Remainder of 2015	$ 5,404
2016	6,550
2017	6,721
2018	6,840
2019	6,980
Thereafter	18,336
Total future minimum lease payments	$ 50,831

Rent expense in the three months ended March 31, 2014 and 2015 was $0.9 million and $1.9 million, respectively. Future minimum lease payments under capital leases, not included in the table above, as of March 31, 2015 are $1.0 million and $0.3 million for remainder of 2015 and 2016, respectively. We have no future minimum lease payments under capital leases extending beyond 2016.

(b) Legal Matters

The Company is involved from time to time in claims that arise in the normal course of its business. The Company is not presently subject to any material litigation nor, to management's knowledge, is any litigation threatened against the Company that collectively is expected to have a material adverse effect on the Company's cash flows, financial condition or results of operations.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Statements that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "seek," "should," "target," "wi expressions or variations intended to identify forward-looking statements. Such statements include, but are not limited to, statements concerning market opportunity, our future financial and operating results, investment strategy, sales and marketing strategy, management's plans, beliefs and objectives for future operations, technology and development, economic and industry trends or trend analysis, expectations about seasonality, opportunity for portfolio purchases, use of non-GAAP financial measures, operating expenses, anticipated income tax rates, capital expenditures, cash flows and liquidity. These statements are based on the beliefs and assumptions of our management based on information currently available to us. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such events.

Overview

We are a leader in administering Consumer-Directed Benefits, or CDBs, which empower employees to save money on taxes while also providing corporate tax advantages for employers. We are solely dedicated to administering CDBs, including pre-tax spending accounts such as health and dependent care Flexible Spending Accounts, or FSAs, Health Savings Accounts, or HSAs, Health Reimbursement Arrangements, or HRAs, as well as commuter benefit services, including transit and parking programs, wellness programs, COBRA and other employee spending account benefits, in the United States.

We deliver our CDB programs through a highly scalable delivery model that employer clients and their employee participants may access through a standard web browser on any internet-enabled device, including computers, smart phones and other mobile devices such as tablet computers. Our on-demand delivery model eliminates the need for our employer clients to install and maintain hardware and software in order to support CDB programs and enables us to rapidly implement product enhancements across our entire user base.

Our CDB programs assist employees and their families in saving money by using pre-tax dollars to pay for certain of their healthcare, dependent care and commuter expenses. Employers financially benefit from our programs through reduced payroll taxes, even after factoring in our fees. Under our FSA, HSA and commuter programs, employee participants contribute funds from their pre-tax income to pay for qualified out-of-pocket healthcare expenses not fully covered by insurance, such as co-pays, deductibles and over-the-counter medical products or for commuting costs.

These employee contributions result in savings to both employees and employers. As an example, based on our average employee participant's annual FSA contribution of approximately $1,300 and an assumed personal combined federal and state income tax rate of 35%, an employee participant will reduce his or her taxes by approximately $455 per year by participating in an FSA. Our employer clients also realize payroll tax (i.e., FICA and Medicare) savings on the pre-tax contributions made by their employees. In the above FSA example, an employer client would save approximately $56 per participant per year, even after the payment of our fees.

Under our HRA programs, employer clients provide their employee participants with a specified amount of available reimbursement funds to help their employee participants defray out-of-pocket medical expenses such as deductibles, co-insurance and co-payments. All amounts paid by the employer into HRAs are deductible by the employer as an ordinary business expense and are tax-free to the employee.

We administer COBRA continuation services to employer clients to meet the employer's obligation to make available continuation of coverage for participants who are no longer eligible for the employer's COBRA covered benefits. As part of our COBRA program, we offer a direct billing service where former employee participants pay for coverage they elect to continue and we ensure our employer clients meet the challenging aspects of COBRA compliance and administration.

Benefit plan years customarily run concurrently with the calendar year and have an open enrollment period that typically occurs at benefit plan year-end during the fourth quarter of the calendar year. Most of our healthcare CDB agreements are executed in the last

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quarter of the calendar year. Because the signing of our contract often coincides with open enrollment, employer clients are able to offer our CDB programs to their employees during open enrollment for the upcoming benefit year. As a result of this timing, we are able to obtain significant visibility into our healthcare-related revenue early on in each plan year because healthcare benefit plans are administered on an annual basis, contractual revenue is based on the number of participants enrolled in our CDB programs on a per month basis and the minimum number of enrolled participants for the plan year is usually established at the close of the open enrollment period. In contrast to healthcare CDB programs, enrollment in commuter programs occurs on a monthly basis. Therefore, there is less visibility and some variability in commuter revenue from month-to-month, particularly during the summer vacation period when employee participants are less likely to participate in commuter programs for those months.

Key Components of Our Results of Operations

Revenue

We generate revenue from the following sources: healthcare solutions, commuter solutions, COBRA, and other services.

Healthcare Revenue

We derive our healthcare revenue from the service fees paid by our employer clients for the administration services we provide in connection with their employee participants' healthcare FSA, dependent care FSA, HRA and HSA tax-advantaged accounts. Our fee is generally fixed for the duration of the written agreement with our employer client, which is typically three years for our enterprise clients and one to three years for our small-and medium-sized business, or SMB, clients. These fees are paid to us on a monthly basis by our employer clients, and the related services are made available to employee participants pursuant to written agreements between us and each employer client. Almost all of the healthcare benefit plans we service on behalf of our enterprise employer clients are subject to contractual minimum monthly billing amounts. Generally, such minimum billing amounts are subject to upward revision on a monthly basis as our employer clients hire new employees who elect to participate in our programs, but generally are not subject to downward revision when employees leave their employers because we continue to administer those former employee participants' accounts for the remainder of the plan year. For SMB employer clients, the monthly fee remains constant for the plan year unless there is a 10% or greater increase in the number of employee participants in which case it is subject to upward revision. Revenue is recognized monthly as services are rendered under our written service agreements.

We also earn interchange revenue from debit cards used by employee participants in connection with all of our healthcare programs and through our wholesale card program, which we recognize monthly based on reports received from third parties. We also earn revenue from self-service plan kits called Premium Only Plan kits, or POP revenue.

Commuter Revenue

For our Commuter Order Model, or COM, Commuter Account Model, or CAM and Commuter Express, we derive our commuter revenue from monthly service fees paid by our employer clients, interchange revenue that we receive from debit cards used by employee participants in connection with our commuter solutions and revenue from the sale of transit passes used in our commuter solutions. Our fees from employer clients are normally paid monthly in arrears based on the number of employee participants enrolled for the month. Most agreements have volume tiers that adjust the per participant price based upon the number of participants enrolled during that month. Revenue is recognized monthly as services are rendered under these written service agreements. We earn interchange revenue from the debit cards used by employee participants in connection with our commuter programs, which we recognize monthly based on reports received from third parties. We also receive commissions from transit passes, which we purchase from various transit agencies on behalf of employee participants. Due to our significant volume, we receive commissions on these passes which we recognize as vendor commission revenue. Commission revenue is recognized on a monthly basis as transactions are placed under written purchase agreements having stipulated terms and conditions, which do not require management to make any significant judgments or assumptions regarding any potential uncertainties.

Revenue from the TransitChek Basic program is based on a percentage of the face value of the transit and parking passes ordered by employer clients and revenue from the TransitChek Premium program is derived from monthly service fees paid by employer clients based on the number of participants. In both programs, revenues also include interchange revenue that we receive from debit cards used by employee participants in connection with our commuter solutions. We also recognize revenue on our estimate of certain passes that will expire unused over the estimated useful life of the passes, as the amounts paid for these passes are nonrefundable to both the employer client and the employee participant.

COBRA Revenue

Our COBRA revenue, is derived from the administration services we provide to employer clients for continuation of coverage for participants who are no longer eligible for the employer's health benefits, such as medical, dental, vision, and for the continued administration of the employee participants’ HRAs and certain healthcare FSAs. Our agreements to provide COBRA services are not consistently structured and we receive fees based on a variety of methodologies.

Other Revenue

Other revenue includes enrollment and eligibility services, employee account administration (i.e., tuition and health club reimbursements) and project-related professional fees. We also derive other revenue from administrative services we provide to a customer to operate their health insurance exchange business which includes enrollment, billing, customer service and payment processing services. Other services revenue is recognized as services are rendered under our written service agreements.

Costs and Expenses

Cost of Revenues (excluding the amortization of internal use software)

Cost of revenues includes the costs of providing services to our employer clients’ employee participants.

The primary component of cost of revenues is personnel expenses and the expenses related to our claims processing, product support and customer service personnel. Cost of revenues includes outsourced and temporary help costs, check/ACH payment processing services, debit card processing services, shipping and handling costs for cards and passes and employee participant communications costs.

Cost of revenues also includes the losses or gains associated with processing our large volume of transactions, which we refer to as “net processing losses or gains.” In the normal course of our business, we make administrative and processing errors that we cannot bill to our employer clients. For example, we may over-reimburse employee participants for claims they submit or incur the cost of replacing commuter passes that are not received by employee participants. Upon identifying such an error, we record the expense as a processing loss. In certain circumstances, we experience recoveries with respect to these amounts which are recorded as processing gains.

Cost of revenues does not include amortization of internal use software or change in contingent consideration, which are included in amortization and change in contingent consideration, or the cost of operating on-demand technology infrastructure, which is included in technology and development expenses.

Technology and Development

Technology and development expenses include personnel and related expenses for our technology operations and development personnel as well as outsourced programming services, the costs of operating our on-demand technology infrastructure, depreciation of equipment and software licensing expenses. During the planning and post-implementation phases of development, we expense, as incurred, all internal use software and website development expenses associated with our proprietary scalable delivery model. During the development phase, costs incurred for internal use software are capitalized and subsequently amortized once the software is available for its intended use. See “Amortization and Change in Contingent Consideration” below. Expenses associated with the platform content or the repair or maintenance of the existing platforms are expensed as incurred.

Sales and Marketing

Sales and marketing expenses consist primarily of personnel and related expenses for our sales, client services and marketing staff, including sales commissions for our direct sales force and external agent/broker commission expense, as well as communication, promotional, public relations and other marketing expenses.

General and Administrative

General and administrative expenses include personnel and related expenses of and professional fees incurred by our executive, finance, legal, human resources and facilities departments.

Amortization and Change in Contingent Consideration

Amortization and change in contingent consideration expense includes amortization of internal use software, amortization of acquired intangible assets and changes in contingent consideration in connection with portfolio purchases and acquisitions.

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We capitalize internal use software and website development costs incurred during the development phase and we amortize these costs over the technology's estimated useful life, which is generally four years. These capitalized costs include personnel costs and fees for outsourced programming and consulting services.

We also amortize acquired intangible assets consisting primarily of employer client agreements and relationships and broker relationships. Employer client agreements and relationships and broker relationships are amortized on a straight-line basis over an average estimated life.

We measure acquired contingent consideration payable each reporting period at fair value and recognize changes in fair value in our consolidated statements of income each period, until the final amount payable is determined. Increases or decreases in the fair value of the contingent consideration payable can result from changes in revenue forecasts, discount rates and risk and probability assumptions. Significant judgment is employed in determining the appropriateness of these assumptions in each period.

Other Income (Expense)

Other income (expense) primarily consists of (i) interest income; (ii) interest expense; and (iii) gain (loss) on settlements and other investments.

Provision for Income Taxes

We are subject to taxation in the United States. Income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. As of March 31, 2015, we remain in a net deferred tax asset position. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

At December 31, 2014, we had federal and state operating loss carryforwards of approximately $38.5 million and $47.0 million, respectively, available to offset future regular and alternative minimum taxable income. The state net operating loss carryforward is on the post-apportionment basis. Our federal net operating loss carryforwards expire in the years 2024 through 2033, if not utilized. The state net operating loss carryforwards expire in the years 2018 through 2033. The federal and state net operating loss carryforwards include excess tax deductions related to stock options in the amount of $21.8 million and $16.2 million, respectively. When utilized, the related excess tax benefit will be booked to additional paid-in capital. We also have tax deductible goodwill related to asset acquisitions.

We have federal and California research and development credit carryforwards of approximately $4.7 million and $2.4 million respectively, available to offset future tax liabilities. The federal research credit carryforwards expire beginning in 2022 through 2034, if not fully utilized. The California tax credit carryforward can be carried forward indefinitely.

Our ability to utilize the net operating losses and tax credit carryforwards are subject to restrictions, including limitations in the event of past or future ownership changes as defined in Section 382 of the Internal Revenue Code (“IRC”) of 1986, as amended, and similar state tax law. In general, an ownership change occurs if the aggregate stock ownership of certain stockholders increases by more than 50 percentage points over such stockholders’ lowest percentage ownership during the testing period (generally three years). We have considered Section 382 of the IRC and concluded that any ownership change would not diminish our utilization of the net operating loss or research and development credits during the carryover periods.

We make estimates and judgments about our future taxable income that are based on assumptions that are consistent with our plans and estimates. Should the actual amounts differ from our estimates, our provision for income taxes could be materially affected.

Critical Accounting Policies and Significant Management Estimates

There have been no material changes to our critical accounting policies and estimates during the three months ended March 31, 2015, as compared to the critical accounting policies and estimates disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the year ended December 31, 2014.

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Results of Operations

Comparison of the Three Months Ended March 31, 2014 and 2015

Revenue

	Three Months Ended March 31,		Change from
	2014	2015	prior year
Revenue:	(in thousands, unaudited)		
Healthcare	$ 39,984	$ 47,289	18%
Commuter	16,043	15,897	-1%
COBRA	4,038	12,570	211%
Other	2,555	9,540	273%
Total revenue	$ 62,620	$ 85,296	36%

Healthcare Revenue

The $7.3 million increase in healthcare revenue for the first quarter of 2015 as compared to the first quarter of 2014 was primarily driven by a $6.7 million increase in FSA and HRA revenue. The FSA and HRA revenue increase was primarily driven by $4.9 million in post-purchase revenues for CONEXIS, which was acquired in August 2014, with the remaining increase being driven by the addition of two significant clients and growth in new employee participation in our programs. Healthcare revenue was further increased by a $0.6 million increase in HSA revenue, due to growth in employee participation in this program.

Commuter Revenue

The $0.1 million decrease in commuter revenue for the first quarter of 2015 as compared to the first quarter of 2014 was driven by the reduction in the maximum pre-tax monthly benefit for transit and vanpooling, which for 2015 is at $130 per month.

COBRA Revenue

The $8.5 million increase in COBRA revenue for the first quarter of 2015 as compared to the first quarter of 2014 was primarily driven by post-purchase revenues for CONEXIS.

Other Revenue

The $7.0 million increase in other revenue for the first quarter of 2015 as compared to the first quarter of 2014 was primarily driven by post-purchase revenues for CONEXIS, related to administrative services we provide to a customer to operate their health insurance exchange business.

Cost of Revenues

	Three Months Ended March 31,		Change from prior year
	2014	2015	
	(in thousands, unaudited)		
Cost of revenues (excluding amortization of internal use software)	$ 22,797	$ 32,071	41%
Percent of revenue	36%	38%	

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The $9.3 million increase in cost of revenues for the first quarter of 2015 as compared to the first quarter of 2014 was primarily due to the inclusion of post-purchase expense of $7.6 million for CONEXIS, which was acquired in August 2014. Cost of revenues was also increased by outsourced services costs of $0.6 million due to processing and supporting an increased number of employee participants and by a $0.6 million increase in stock-based compensation expense due to new grants, since the first quarter of 2014, of performance-based restricted stock units as well as stock options. Cost of revenues was further driven by an increase in salaries and personnel-related costs of $0.5 million due to an increase in headcount to support employee participant growth.

As we continue to scale our operations, we expect our cost of revenues to increase in dollar amount to support increased employer client and employee participant levels. Cost of revenues will continue to be affected by our portfolio purchases, acquisitions and channel partner arrangements. Prior to migrating to our proprietary technology platforms, these new portfolios often operate with higher service delivery costs that result in increased cost of revenues until we are able to complete the migration process, which typically occurs over the 12- to 24-month period following closing of the portfolio purchase or acquisition.

Technology and Development

	Three Months Ended March 31,		Change from prior year
	2014	2015	
	(in thousands, unaudited)		
Technology and development	$ 5,199	$ 10,585	104%
Percent of revenue	8%	12%	

The $5.4 million increase in technology and development expenses for the first quarter of 2015 as compared to the first quarter of 2014 was primarily due to the inclusion of post-purchase expense of $4.8 million for CONEXIS, which was acquired in August 2014. Excluding CONEXIS, technology and development expenses increased by $0.4 million, due to greater capitalization of software development costs in the first quarter of 2014 compared to the first quarter of 2015.

We intend to continue enhancing the functionality of our software platform as part of our continuous effort to improve our employer client and employee participant experience and to maintain and enhance our control and compliance environment. As we realize synergies and consolidate projects, the dollar amount spent on technology and development has decreased. The timing of development and enhancement projects, including whether they are in phases where costs are capitalized or expensed, will significantly affect our technology and development expense both in dollar amount and as a percentage of revenue.

Sales and Marketing

	Three Months Ended March 31,		Change from prior year
	2014	2015	
	(in thousands, unaudited)		
Sales and marketing	$ 9,367	$ 13,131	40%
Percent of revenue	15%	15%	

The $3.8 million increase in sales and marketing expense for the first quarter of 2015 as compared to the first quarter of 2014 was primarily due to the inclusion of post-purchase expense of $2.8 million for CONEXIS, which was acquired in August 2014, as well as an increase in salaries and personnel-related costs of $0.4 million due to increased hiring of sales and marketing personnel to support ongoing sales and marketing programs. Sales and marketing expenses were further driven by an increase in stock-based compensation expense of $0.3 million due to new grants, since the first quarter of 2014, of performance-based restricted stock units as well as stock options.

We intend to continue to invest in sales, client services and marketing by hiring additional personnel and continuing to build our broker and channel relationships. We also intend to promote our brand through a variety of marketing and public relations activities. As a result, we expect our sales and marketing expenses to increase in dollar amount in future periods.

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General and Administrative

	Three Months Ended March 31,		Change from prior year
	2014	2015	
	(in thousands, unaudited)		
General and administrative	$ 9,932	$ 13,565	37%
Percent of revenue	16%	16%	

The $3.6 million increase in general and administrative expenses for the first quarter of 2015 as compared to the first quarter of 2014 was primarily due to the inclusion of post-purchase expense of $1.6 million for CONEXIS, which was acquired in August 2014. The increase in general and administrative expenses were further driven by an increase of $1.6 million in stock-based compensation expense primarily due to new grants, since the first quarter of 2014, of stock options, restricted stock units and performance-based restricted stock units. The remaining increase in general and administrative expenses were primarily driven by an increase in rent expense.

As we continue to grow, we expect our general and administrative expenses to continue to increase in dollar amount as we expand general and administrative headcount to support our continued growth.

Amortization and Change in Contingent Consideration

	Three Months Ended March 31,		Change from prior year
	2014	2015	

	(in thousands, unaudited)		
Amortization and change in contingent consideration	$ 4,420	$ 6,279	42%

The increase in the amortization and change in contingent consideration line item for the first quarter of 2015 when compared to the first quarter of 2014, was primarily driven by an increase in amortization of acquired intangible assets expense related to the CONEXIS acquisition and Ceridian channel partnership arrangement.

Other Income (Expense)

	Three Months Ended March 31,	
	2014	2015
	(in thousands, unaudited)	
Interest income	$ 1	$ 2
Interest expense	(257)	(575)
Other income	13	66

The increase in the interest expense line item for the first quarter of 2015 when compared to the first quarter of 2014, is due to the increase in borrowing under the line of credit with MUFG Union Bank related to the acquisition of CONEXIS.

Income Taxes

	Three Months Ended March 31,	
	2014	2015

	(in thousands, unaudited)	
Income tax provision	$ (4,218)	$ (3,519)

Our provision for income taxes decreased from $4.2 million for the first quarter of 2014 to $3.5 million for the first quarter of 2015 due primarily to a decrease in income before income taxes for the first quarter of 2015.

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Liquidity and Capital Resources

At March 31, 2015, our principal sources of liquidity were cash and cash equivalents totaling $451.8 million comprised primarily of prefunds by clients of amounts to be paid on behalf of employee participants as well as, in recent years, other cash flows from operating activities.

We believe that our existing cash and cash equivalents and expected cash flow from operations will be sufficient to meet our operating and capital requirements, as well as anticipated cash requirements for potential future portfolio purchases, over at least the next 12 months. We have historically been able to fulfill our obligations as incurred and expect to continue to fulfill our obligations in the future. Our expectation is based on our current and anticipated client retention rates and our continuing funding model in which the vast majority of our enterprise clients provide us with prefunds as more fully described below under "—Prefunds." To the extent these current and anticipated future sources of liquidity are insufficient to fund our future business activities and requirements, including any potential portfolio purchases; we may need to raise additional funds through public or private equity or debt financing. We cannot provide assurance that we will be able to raise additional funds on favorable terms, if at all.

Prefunds

Under our contracts with the vast majority of our enterprise employer clients, we receive prefunds that have been and are expected to continue to be a significant source of cash flows from operating activities. Each prefund is reflected in cash and cash equivalents on our balance sheet with an equivalent customer obligation recorded as a liability as the prefund is received. Changes in these prefunds and corresponding customer obligations are reflected in our cash flows from operating activities. The substantial majority of our SMB employer clients deposit funds into a separate custodial account, and those funds are neither a source of cash flows from operating activities nor reflected on our balance sheet. These SMB employer clients are responsible for maintaining an adequate balance in those custodial accounts to cover their employee participants' claims. We only pay SMB employee participant claims from amounts in the custodial accounts.

The operation of these prefunds for our enterprise employer clients throughout the year typically is as follows: at the beginning of a plan year, these employer clients provide us with prefunds for their FSA and HRA programs based on a percentage of projected spending by the employee participants for the plan year. In the case of our commuter program, at the beginning of each month we receive prefunds based on the employee participants' monthly elections. These prefunds are typically replenished on a weekly basis by our FSA and HRA employer clients and on a monthly basis by our commuter employer clients, in each case, after we have advanced the funds necessary to process employee participants' FSA and HRA claims as they are submitted to us and to pay vendors relating to our commuter programs.

As a result, our cash balances can vary significantly depending upon the timing of invoicing of, and payment by, our employer clients of reimbursement for payments we have made on behalf of employee participants. This prefunding activity covers our estimate of approximately one week of spending on behalf of the employer client's employee participants. We do not require a prefund to administer any of our HSA programs because employee participants in these programs only have access to funds they have previously contributed.

MUFG Union Bank Credit Facility

Debt consists of borrowings under a Credit Agreement, or Revolver, with MUFG Union Bank, N.A. (formerly Union Bank, N.A.), or UB, under which we can borrow an aggregate principal amount of up to $125.0 million, with a $15.0 million subfacility for the issuance of letters of credit. At March 31, 2015, we had $79.6 million principal amount outstanding under the Revolver. The debt under the Revolver is scheduled to mature on July 21, 2017.

Each loan under the Revolver bears interest at a fluctuating rate per annum equal to a prime rate determined in accordance with the terms of the Revolver, plus a spread of 0.00% to 0.25%, or at our option, a LIBOR rate determined in accordance with the Revolver, plus a spread of 1.75% to 2.25%.

As collateral for the Revolver, we granted UB a security interest in substantially all of our assets. All of our material existing and future subsidiaries are required to guaranty our obligations under the Revolver. Such guarantees by existing and future material subsidiaries are and will be secured by substantially all of the property of such material subsidiaries.

The Revolver contains customary affirmative and negative covenants and also has financial covenants relating to a liquidity ratio, a consolidated leverage ratio, a debt service coverage ratio and a minimum consolidated net worth covenant. We are obligated to pay customary commitment fees and letter of credit fees for a facility of this size and type. We are currently in compliance with all financial and non-financial covenants under the Revolver.

The Revolver contains customary events of default, including, among others, payment defaults, covenant defaults, inaccuracy of representations and warranties, cross-defaults to other material indebtedness, judgment defaults, a change of control default and

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bankruptcy and insolvency defaults. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the loan agreement at a per annum rate of interest equal to 2.00% above the applicable interest rate. Upon an event of default, the lenders may terminate the commitments, declare the outstanding obligations payable by us to be immediately due and payable and exercise other rights and remedies provided for under the Revolver.

Cash Flows

The following table presents information regarding our cash and cash equivalents as of December 31, 2014 and March 31, 2015:

	December 31, 2014	March 31, 2015
	(in thousands)	
	(unaudited)	
Cash and cash equivalents, end of period	$ 413,301	$ 451,842

The following table presents information regarding our cash flows for the three months ended March 31, 2014 and 2015:

	March 31,	
	2014	2015
	(in thousands)	
	(unaudited)	
Net cash provided by (used in) operating activities	$ (10,795)	$ 38,030
Net cash used in investing activities	(3,233)	(5,972)
Net cash provided by financing activities	7,410	6,483
Net increase (decrease) in cash and cash equivalents	$ (6,618)	$ 38,541

Cash Flows from Operating Activities

	March 31,	
	2014	2015
	(in thousands)	
	(unaudited)	
Net cash provided by (used in) operating activities	$ (10,795)	$ 38,030

Net cash from operating activities increased during the three months ended March 31, 2015 when compared to the three months ended March 31, 2014, primarily due to the timing of our billing, and employer client payments of 2015 prefunds when compared to a year ago.

Cash Flows from Investing Activities

March 31,

	2014	2015
	(in thousands)	
	(unaudited)	
Net cash used in investing activities	$ (3,233)	$ (5,972)

Net cash used in investing activities consists of investment in internal use software that is capitalized prior to it being available for its intended use and capital expenditures.

Net cash used in investing activities increased during the three months ended March 31, 2015 when compared to the three months ended March 31, 2014, due to increased capital expenditures.

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Cash Flows from Financing Activities

	March 31,	
	2014	2015
	(in thousands)	
	(unaudited)	
Net cash provided by financing activities	$ 7,410	$ 6,483

Net cash provided by financing activities decreased during the three months ended March 31, 2015 when compared to the three months ended March 31, 2014, due to a reduction in proceeds from the exercise of employee stock options and contributions to the our Employee Stock Purchase Plan.

Contractual Obligations

The following table describes our contractual obligations as of March 31, 2015 (unaudited):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations (1)	$ 79,600	$ —	$ 79,600	$ —	$ —
Interest on long-term debt obligations (2)	4,590	1,967	2,623	—	—
Operating lease obligations (3)	50,831	6,820	13,558	13,825	16,628
Acquisition payments (4)	4,230	4,230	—	—	—

CONEXIS holdback obligation (5)	10,000	10,000	—	—	—
Total	$ 149,251	$ 23,017	$ 95,781	$ 13,825	$ 16,628

(1) Credit facility as of March 31, 2015 is $125.0 million with a variable interest rate of base rate plus a spread of 0.00% to 0.25% per annum or LIBOR plus a spread of 1.75% to 2.25% per annum, and a maturity date of July 21, 2017. At March 31, 2015, we had $79.6 million of outstanding principal which is recorded net of debt issuance costs on our balance sheet. The debt issuance costs are not included in the table above.
(2) Estimated interest payments assume the interest rate applicable as of March 31, 2015 of 2.50% per annum on a $79.6 million principal amount.
(3) We lease facilities under non-cancelable operating leases expiring at various dates through 2023.
(4) Estimated undiscounted contingent consideration for businesses acquired in 2012 and 2013.
(5) Expected payment of holdback amount related to the CONEXIS acquisition, expected to be paid on August 1, 2015.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may affect our financial position due to adverse changes in financial market prices and rates. We are exposed to market risks related to changes in interest rates.

As of March 31, 2015, we had cash and cash equivalents of $451.8 million. These amounts consist of cash on deposit with banks and money market funds. The cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we do not believe that changes in interest rates would have a material impact on our financial position and results of operations. However, declines in interest rates and cash balances will reduce future interest income.

The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This objective is accomplished by making diversified investments, consisting only of investment grade securities. The decrease in interest income from the effect of a hypothetical decrease in short-term interest rates of 10% would not have a material impact on our net income and cash flows.

Our exposure to market risk also relates to the increase or decrease in the amount of interest expense we must pay on our outstanding debt instruments. As of March 31, 2015, we had outstanding principal of $79.6 million under our credit facility. Each loan under the credit facility bears interest at a fluctuating rate per annum equal to a prime rate determined in accordance with the credit agreement, plus a spread of 0.00% to 0.25%, or at our option, a LIBOR rate determined in accordance with the credit agreement, plus a spread of 1.75% to 2.25%, as of March 31, 2015. The increase in interest expense from the effect of a hypothetical change in interest rates of 1% would not have a material impact on our net income and cash flows.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, or the SEC, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures.

Subject to the limitations noted above, based on their evaluation at the end of the period covered by this quarterly report on Form 10-Q, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company’s disclosure controls and procedures and have concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) or the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time-to-time, we may be subject to various legal proceedings and claims that arise in the normal course of our business activities. As of the date of this Quarterly Report on Form 10-Q, we are not a party to any litigation whereby the outcome of such litigation, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our results of operations, prospects, cash flows, financial position or brand.

Item 1A. Risk Factors

RISK FACTORS

You should carefully consider the risks described below together with the other information set forth in this report, which could materially affect our business, financial condition and future results. The risks described below are not the only risks facing our company. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and operating results. If any of the following risks is realized, our business, financial condition, results of operations and prospects could be materially and adversely affected. In that event, the trading price of our common stock could decline.

Our business is dependent upon the availability of tax-advantaged consumer-directed benefits to employers and employees and any diminution in, elimination of, or change in the availability of these benefits would materially adversely affect our results of operations, financial condition, business and prospects.

Our business fundamentally depends on employer and employee demand for tax-advantaged Consumer-Directed Benefits, or CDBs. Any diminution in or elimination of the availability of CDBs for employees would materially adversely affect our results of operations, financial condition, business and prospects. In addition, incentives for employers to offer CDBs may also be reduced or eliminated by changes in laws that result in employers no longer realizing financial gain from the implementation of these benefits. If employers cease to offer CDB programs or reduce the number of programs they offer to their employees, our results of operations, financial condition, business and prospects would also be materially adversely affected. We are not aware of any reliable statistics on the growth of CDB programs and cannot assure you that participation in CDB programs will grow.

In addition, if the payroll tax savings employers currently realize from their employees' utilization of CDBs become reduced or unavailable, employers may be less inclined to offer these programs to their employees. If the tax savings currently realized by employee participants by utilizing CDBs were reduced or unavailable, we expect employees would correspondingly reduce or eliminate their participation in such CDB plans. Any such reduction in employer or employee incentives would materially adversely affect our results of operations, financial condition, business and prospects.

Future portfolio purchases and acquisitions are an important aspect of our growth strategy, and any failure to successfully identify, acquire or integrate acquisitions or additional portfolio targets could materially adversely affect our ability to grow our business. In addition, costs of integrating acquisitions and portfolio purchases may adversely affect our results of operations in the short term.

Our recent growth has been, and our future growth will be, substantially dependent on our ability to continue to make and integrate acquisitions and complementary portfolio purchases to expand our employer client base and service offerings. Since 2007, we have completed seven portfolio purchases and two acquisitions. Our most recent acquisition of CONEXIS was completed in August 2014. Our successful integration of these portfolio purchases and acquisitions into our operations on a cost-effective basis is critical to our future financial performance. While we believe that there are numerous potential portfolio purchases and acquisitions that would add to our employer client base and service offerings, we cannot assure you that we will be able to successfully make a sufficient number of such portfolio purchases or acquisitions in a timely and effective manner in order to support our growth objectives. In addition, the process of integrating portfolio purchases and acquisitions may create unforeseen difficulties and expenditures. We face various risks in making portfolio purchases and any acquisitions, including:

- our ability to retain acquired employer clients and their associated revenues;
- diversion of management's time and focus from operating our business to address integration challenges;
- our ability to retain or replace key employees from acquisitions and portfolios we acquire;
- cultural and logistical challenges associated with integrating employees from acquired portfolios into our organization;

- our ability to integrate the combined products, services and technology;
- the migration of acquired employer clients to our technology platforms;
- our ability to cross-sell additional CDB programs to acquired employer clients;
- our ability to realize expected synergies;
- the need to implement or improve internal controls, procedures and policies appropriate for a public company at businesses that, prior to the portfolio purchase or acquisition, may have lacked effective controls, procedures and policies, including, but not limited to, processes required for the effective and timely reporting of the financial condition and results of operations of the acquired business, both for historical periods prior to the acquisition and on a forward-looking basis following the acquisition;
- possible write-offs or impairment charges that result from acquisitions and portfolio purchases;
- unanticipated or unknown liabilities that relate to purchased businesses;
- the need to implement or improve internal controls relating to privacy, security and data protection;
- the need to integrate purchased businesses' accounting, management information, human resources, and other administrative systems to permit effective management; and
- any change in one of the many complex federal or state laws or regulations that govern any aspect of the financial or business operations of our business and businesses we acquire, such as state escheatment laws.

Portfolio purchases and acquisitions may have a short-term material adverse impact on our results of operations, including a potential material adverse impact on our cost of revenues, as we seek to migrate acquired employer clients to our proprietary technology platforms, typically over the succeeding 12 to 24 months, in order to achieve additional operating efficiencies. Additionally, from time to time, we may incur material costs and charges related to consolidating our operations following our portfolio purchases and acquisitions.

If we are unable to retain and expand our employer client base and establish new channel partnerships, our results of operations, financial condition, business and prospects would be materially adversely affected.

Most of our revenue is derived from the long term, multi-year agreements that we typically enter into with our employer clients. The initial subscription period is typically three years for our larger employer clients, which we refer to as enterprise clients, and one to three years for our SMB clients. We also derive revenue from our channel partner agreements with American Family Life Assurance Company, or Aflac, and Ceridian. We anticipate in the future establishing new channel partnerships with other companies. Our employer clients, however, have no obligation to renew their agreements with us after the initial term and we cannot assure you that our employer clients will continue to renew their agreements at the same rate, if at all. In addition, employer clients transitioning to us from a channel partner have no obligation to enter into agreements with us and, if they do, there is no guarantee that they will renew their agreements with us after the initial transition period.

Moreover, most of our employer clients have the right to cancel their agreements for convenience, subject to certain notice requirements. While few employer clients have terminated their agreements with us for convenience, some of our employer clients have elected not to renew their agreements with us. Our employer clients’ renewal rates may decline or fluctuate as a result of a number of factors, including the prices of competing products or services or reductions in our employer clients’ spending levels.

Another important aspect of our growth strategy depends upon our ability to maintain our existing channel partner relationships and develop new relationships. No assurance can be given that new channel partners will be found, that any such new relationships will be successful when they are in place, or that business with our current channel partners will increase at the level necessary to support our growth objectives. If our employer clients do not renew their agreements with us, and we are unable to attract new employer clients or channel partners, our revenue may decline and our results of operations, financial condition, business and prospects may be materially adversely affected.

The market for our services and our business may not grow if our marketing efforts do not successfully raise awareness among employers and employees about the advantages of adopting and participating in CDB programs.

Our revenue model is substantially based on the number of employee participants enrolled in the CDB programs that we administer. We devote significant resources to educating both employers and their employees on the potential cost savings available to them from utilizing CDB programs. We have created various marketing, educational and awareness tools to inform employers about the benefits of offering CDB programs to their employees and how our services allow them to offer these benefits in an efficient and cost effective manner. We also provide marketing information to employees that informs them about the potential tax savings they can achieve by utilizing CDB programs to pay for their healthcare, commuter and other benefit needs. However, if more employers and

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employees do not become aware of or understand these potential cost savings and choose to adopt CDB programs, our results of operations, financial condition, business and prospects may be materially adversely affected.

In addition, there is no guarantee that the market for our services will grow as we expect. For example, the value of our services is directly related to the complexity of administering CDB programs and government action that significantly reduces or simplifies these requirements could reduce demand or pricing for our services. Further, employees may not participate in CDB programs because they have insufficient funds to set aside into such programs, find the rules regarding use of such programs too complex, or otherwise. If the market for our services declines or develops more slowly than we expect, or the number of employer clients that select us to provide CDB programs to their employee participants declines or fails to increase as we expect, our results of operations, financial condition, business and prospects could be materially adversely affected.

Our business and prospects may be materially adversely affected if we are unable to cross-sell our products and services.

A significant component of our growth strategy is the increased cross-selling of products and services to current and future employer clients. In particular, many of our employer clients use only one of our products so we expect our ability to cross-sell our commuter programs to our healthcare program clients and our healthcare programs to our commuter employer clients to be an important part of this strategy. We may not be successful in cross-selling our products and services if our employer clients find our additional products and services to be unnecessary or unattractive. Any failure to sell additional products and services to current and future clients could materially adversely affect our results of operations, financial condition, business and prospects.

We may be unable to compete effectively against our current and future competitors.

The market for our products and services is highly competitive, rapidly evolving and fragmented. We have numerous competitors, including health insurance carriers, such as Aetna, human resources consultants and outsourcers, such as Aon Hewitt, payroll providers, such as ADP, national CDB specialists, such as TASC, and regional third party administrators and commercial banks, such as Bank of America. Many of our competitors, including health insurance carriers, have longer operating histories and significantly greater financial, technical, marketing and other resources than we have. As a result, some of these competitors may be in a position to devote greater resources to the development, promotion, sale and support of their products and services.

In addition, if one or more of our competitors were to merge or partner with another of our competitors, the change in the competitive landscape could materially adversely affect our ability to compete effectively. Our competitors may also establish or strengthen cooperative relationships with our current or future strategic brokers, insurance carriers, payroll services companies, private exchanges, third party advisors or other parties with which we have relationships, thereby limiting our ability to promote our CDB programs with these parties and limiting the number of brokers available to sell or market our programs. If we are unable to compete effectively with our competitors for any of the foregoing reasons, our results of operations, financial condition, business and prospects could be materially adversely affected.

Changes in healthcare, security and privacy laws and other regulations applicable to our business may constrain our ability to offer our products and services.

Changes in healthcare or other laws and regulations applicable to our business may occur that could increase our compliance and other costs of doing business, require significant systems enhancement, or render our products or services less profitable or obsolete, any of which could have a material adverse effect on our results of operations.

The Patient Protection and Affordable Care Act signed into law on March 23, 2010 and related regulations or regulatory actions could adversely affect our ability to offer certain of our CDBs in the manner that we do today or may make CDBs less attractive to some employers. For example, any new laws that increase reporting and compliance burdens on employers may make them less likely to offer CDBs to their employees and instead offer employees benefit coverage through public exchanges. In addition, it is unclear whether the “Cadillac Tax” set to become effective in 2018 will be modified so that employee contributions to FSAs and HSAs are excluded from the calculation or if the entire tax will be repealed. If employers are less incentivized to offer our CDB programs to employees because of the Cadillac Tax, increased regulatory burdens, costs or otherwise, our results of operations and financial condition could be materially adversely affected.

In addition, the numerous federal and state laws and regulations related to the privacy and security of personal health information, in particular those promulgated pursuant to the Health Insurance Portability and Accountability Act of 1996, or HIPAA, require the implementation of administrative, physical and technological safeguards to ensure the confidentiality and integrity of individually identifiable health information in electronic form. We are required to enter into written agreements with all of our employer clients known as Business Associated Agreements. Pursuant to these agreements, and as our employer client’s “Business Associate” thereunder, we are required to safeguard all individually identifiable health information of their participating employees

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and are restricted in how we use and disclose such information. These agreements also contain data security breach notification requirements which, in some circumstances, may be more stringent than HIPAA requirements. As we are unable to predict what changes to HIPAA or other privacy and security laws or regulations might be made in the future, we can't be certain how those changes could affect our business or the costs of compliance.

We plan to extend and expand our products and services and introduce new products and services, and we may not accurately estimate the impact of developing and introducing these products and services on our business.

We intend to continue to invest in technology and development to create new and enhanced products and services to offer our employer clients and their participating employees. During this past year, we have added several new features to our participant site and have continued to enhance the site's mobile compatibility. To increase the value we deliver to our clients, we have also updated the look and feel of our client facing website with the addition of a new graphic dashboard providing users access to key metrics. Scalability of our platform also remains an on-going focus as our platform volume increases. We continue to make investments in technology stack upgrades, to ensure stability and performance of our applications for our clients and participants. Our health and wellness offerings continue to be expanded to include online claims for our wellness product and the integration of a Wellness Portal to provide our users with the most up-to-date health and wellness information. We are developing new technology to handle the enrollment, billing, customer service and payment processing matters associated with a health care carrier's offerings on the public health insurance exchanges. Despite quality testing of the technology prior to use, it may contain errors that impact its function and performance and this may result in negative consequences. We have limited experience in these areas and so we may not be able to anticipate or manage new risks and obligations or legal, compliance or other requirements that may arise. The anticipated benefits of such new and improved products and services may not outweigh the costs and resources associated with their development.

Our ability to attract and retain new employer clients and increase revenue from existing employer clients will depend in large part on our ability to enhance and improve our existing products and services and to introduce new products and services. The success of any enhancement or new product or service depends on several factors, including the timely completion, introduction and market acceptance of the enhancement or new product or service. Any new product or service we develop or acquire may not be introduced in a timely or cost-effective manner and may not achieve the broad market acceptance necessary to generate significant revenue. If we are unable to successfully develop or acquire new products or services or enhance our existing products or services to meet client requirements, our results of operations, financial condition, business or prospects may be materially adversely affected.

If we fail to manage future growth effectively, we may not be able to market and sell our products and services successfully.

We have expanded our operations significantly in recent years and anticipate that further expansion will be required in order for us to grow our business. If we do not effectively manage our growth, the quality of our services could suffer, which could materially adversely affect our results of operations, financial condition, business and prospects, and damage our brand and reputation among existing and prospective clients. In order to manage our future growth, we will need to hire, integrate and retain highly skilled and motivated employees. We will also be required to continue to improve our existing systems for operational and financial information management, including our reporting systems, procedures and controls and regulatory compliance processes. These improvements may require significant capital expenditures and will place increasing demands on our management. We may not be successful in managing or expanding our operations, or in maintaining adequate operating and financial information systems and controls. If we are not successful in implementing improvements in these areas, our results of operations, financial condition, business and prospects would be materially adversely affected.

General economic and other conditions may adversely affect trends in employment and hiring patterns, which could result in lower employee participation in CDB programs, which would materially adversely affect our results of operations, financial condition, business and prospects.

Our revenue is attributable to the number of employee participants at each of our employer clients, which in turn is influenced by the employment and hiring patterns of our employer clients. To the extent our employer clients freeze or reduce their headcount or wages paid because of general economic or other conditions, demand for our programs may decrease, which could materially adversely affect our results of operations, financial condition, business and prospects.

Failure to effectively develop and expand our direct and indirect sales channels may materially adversely affect our results of operations, financial condition, business and prospects and reduce our growth.

We will need to continue to expand our sales and marketing infrastructure in order to grow our employer client base and our business. We rely on our enterprise sales force to target new Fortune 1000 client accounts and sell into the private exchanges, as well as to cross-sell additional products and services to our existing enterprise clients. Effectively training our sales personnel requires

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significant time, expense and attention. In addition, we utilize various channel brokers, including insurance agents, benefits consultants, regional and national insurance carriers, health plans, payroll companies, banks and regional third party administrators, to sell and market our programs to SMB employers. If we are unable to develop and expand our direct sales team, these indirect sales channels, or become a partner to more private exchanges, our ability to attract new employer clients, become a private exchange partner and cross-sell our programs may be negatively impacted and our growth opportunities will be reduced, each of which would materially adversely affect our results of operations, financial condition, business and prospects.

If our efforts to develop and expand our direct and indirect sales channels do not generate a corresponding increase in revenue, our business may be materially adversely affected. In particular, if we are unable to effectively train our sales personnel or if our direct sales personnel are unable to achieve expected productivity levels in a reasonable period of time, we may not be able to increase our revenue and grow our business.

Long sales cycles make the timing of our long-term revenues difficult to predict.

Our average sales cycle ranges from approximately two months for SMBs to six to nine months for our large institutional clients, and, in some cases, even longer depending on the size of the potential client. Factors that may influence the length of our sales cycle include:

- the need to educate potential employer clients about the uses and benefits of our CDB programs;
- the relatively long duration of the commitment clients make in their agreements with us or with pre-existing plan administrators;
- the discretionary nature of potential employer clients’ purchasing and budget cycles and decisions;
- the competitive nature of potential employer clients’ evaluation and purchasing processes;
- fluctuations in the CDB program needs of potential employer clients; and
- lengthy purchasing approval processes of potential employer clients.

The fluctuations that result from the length of our sales cycle may be magnified for large- and mid-sized potential employer clients. If we are unable to close an expected significant transaction with one or more of these potential clients in the anticipated period, our operating results for that period, and for any future periods in which revenue from such transaction would otherwise have been recognized, would be harmed.

Our business and operational results are subject to seasonality as a result of open enrollment for CDB programs and decreased use of commuter program offerings during typical vacation months.

The number of accounts that generate revenue is typically greatest during our first calendar quarter. This is primarily due to two factors. First, new employer clients and their employee participants typically begin service on January 1. Second, during the first calendar quarter, we are also servicing the end of plan year activity for existing clients, including assisting our clients with initiating the deduction of healthcare premiums on a tax deferred basis, and employee participants who do not continue participation into the next plan year.

Generally, in comparison to other quarters, our revenue is highest in the first quarter and lowest in the second and third quarters. Thereafter, our revenue generally grows gradually in the fourth quarter as our employer clients hire new employees who then elect to participate in our programs, thereby increasing our monthly minimum billing amount. The minimum billing amount is not, however, generally subject to downward revision when employees leave their employers because we continue to administer those former employee participants' accounts for the remainder of the plan year. Revenue from commuter programs may vary from month-to-month because employees may elect to participate in our commuter programs at any time during the year and may change their election to participate or the amount of their contribution on a monthly basis; however, participation rates in our commuter business typically slow during the summer as people take vacations and do not purchase transit passes or parking passes during that time.

Our operating expenses increase during the fourth quarter because of increased debit card production and because we increase our customer support center capacity to answer questions from employee participants during the open enrollment periods related to their CDB participation decisions. The cost of providing services peaks in the first quarter as new employee participants contact us for information about their CDBs, and as terminating employee participants submit their final claims for reimbursement.

Our operating results can fluctuate from period to period, which could cause our share price to fluctuate.

Fluctuations in our quarterly operating results could cause our stock price to decline rapidly, may lead analysts to change their long-term models for valuing our common stock, could cause short-term liquidity issues, may impact our ability to retain or attract key personnel or cause other unanticipated issues. If our quarterly operating results or guidance fall below the expectations of research analysts or investors, the price of our common stock could decline substantially. Our quarterly operating expenses and operating results may vary significantly in the future and period-to-period comparisons of our operating results may not be meaningful. You should not rely on the results of one quarter as an indication of future performance.

If employee participants do not continue to utilize our prepaid debit cards or choose to use PIN rather than signature enabled prepaid debit cards, our results of operations, business and prospects could be materially adversely affected.

We derive a portion of our revenue from interchange fees that are paid to us when employee participants utilize our prepaid debit cards to pay for certain healthcare and commuter expenses under our CDB programs. These fees represent a percentage of the expenses transacted on each debit card. If our employer clients do not adopt these prepaid debit cards as part of the benefits programs they offer, if the employee participants do not use them at the rate we expect, if employee participants choose to process their transactions over PIN networks rather than signature networks or if other alternatives to prepaid tax-advantaged benefit cards develop, our results of operations, business and prospects could be materially adversely affected.

If we are unable to maintain and enhance our brand and reputation, our ability to sustain and grow our business may be materially adversely affected.

Maintaining and strengthening our brand is critical to attracting new clients and growing our business. Our ability to maintain and strengthen our brand and reputation will depend heavily on our capacity to continue to provide high levels of customer service to our employer clients and their employee participants at cost effective and competitive prices, which we may not do successfully. In addition, our continued success depends, in part, on our reputation as an industry leader in promoting awareness and understanding of the positive impact of CDBs among employers and employees. If we fail to successfully maintain and strengthen our brand, our results of operations, financial condition, business and prospects will be materially adversely affected.

Some plan providers with which we have relationships also provide, or may provide, competing services.

We face competitive risks in situations where some of our strategic partners are also current or potential competitors. For example, certain of the banks we utilize as custodians of the funds for our HSA employee participants also offer their own HSA products. To the extent that these partners choose to offer competing products and services that they have developed or in which they have an interest to our current or potential clients, our results of operations, business and prospects could be materially adversely affected.

We are subject to complex regulation, and any compliance failures or regulatory action could materially adversely affect our business.

The plans we administer and, as a result, our business are subject to extensive, complex and continually changing federal and state laws and regulations, including the Affordable Care Act, IRS regulations, ERISA, privacy and HIPAA regulations and Department of Labor regulations, all of which are further described in our Annual Report on Form 10-K under the heading "Business — Government Regulation". If we fail to comply with any applicable law, rule or regulation, we could be subject to fines and penalties, indemnification claims by our clients, or become the subject of a regulatory enforcement action, each of which would materially adversely affect our business and reputation.

We may also become subject to additional regulatory and compliance requirements as a result of changes in laws or regulations, or as a result of any expansion or enhancement of our existing products and services or the development of any new products or services in the future. For example, if we expand our product and service offerings into the health insurance market in the future, we would become subject to state Department of Insurance regulations. Compliance with any new regulatory requirements may divert internal resources and take significant time and effort.

Any claims of noncompliance brought against us, regardless of merit or ultimate outcome, could subject us to investigation by the Department of Labor, the Internal Revenue Service, the Centers for Medicare and Medicaid Services, the Treasury Department or other federal and state regulatory authorities, which could result in substantial costs to us and divert management's attention and other resources away from our operations. In addition, investor perceptions of us may suffer and could cause a decline in the market price of

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our common stock. Our compliance processes may not be sufficient to prevent assertions that we failed to comply with any applicable law, rule or regulation.

Failure to ensure and protect the confidentiality and security of participant data could lead to legal liability, adversely affect our reputation and have a material adverse effect on our results of operations, business or financial condition.

We must collect, store and use employee participants' confidential information, and transmit that data to third parties, to provide our services. For example, we collect names, addresses, social security numbers and other personally identifiable information from employee participants. In addition, we facilitate the issuance and funding of prepaid debit cards and, in some cases, collect bank routing information, account numbers and personal credit card information for purposes of funding an account or issuing a reimbursement. We have invested significantly in preserving the security of this data.

In addition, we utilize third-party platforms and outsource customer support center services and claims processing services to third-party service providers to whom we transmit certain confidential information of our employee participants. We have security measures in place with each of these service providers to help protect this confidential information, including written agreements that outline how protected health information will be handled and shared. However, there are no assurances that these measures, or any additional security measures that our service providers may have in place, will be sufficient to protect this outsourced confidential information from unauthorized security breaches.

We cannot assure you that, despite the implementation of these security measures, we will not be subject to a security incident or other data breach or that this data will not be compromised. We may be required to expend significant capital and other resources to protect against security breaches or to alleviate problems caused by security breaches, or to pay penalties as a result of such breaches. Despite our implementation of security measures, techniques used to obtain unauthorized access or to sabotage systems change frequently. As a result, we may be unable to anticipate these techniques or implement adequate preventative measures to protect this data. In addition, security breaches can also occur as a result of non-technical issues, including intentional or inadvertent breaches by our employees or service providers or by other persons or entities with whom we have commercial relationships. Any compromise or perceived compromise of our security could damage our reputation with our clients, brokers and channel partners, and could subject us to significant liability, as well as regulatory action, including financial penalties, which would materially adversely affect our brand, results of operations, financial condition, business and prospects.

We have incurred, and expect to continue to incur, significant costs to protect against and respond to security breaches. We may incur significant additional costs in the future to address problems caused by any actual or perceived security breaches.

Breaches of our security measures or those of our third-party service providers or security incidents could result in unauthorized access to our sites, networks and systems; unauthorized access to, misuse or misappropriation of employer client or employee participants' information, including personally identifiable information, or other confidential or proprietary information of ourselves or third parties; viruses, worms, spyware or other malware being served from our sites, networks or systems; deletion or modification of content or the display of unauthorized content on our sites; interruption, disruption or malfunction of operations; costs relating to notification of individuals, or other forms of breach remediation; deployment of additional personnel and protection technologies; response to governmental investigations and media inquiries and coverage; engagement of third party experts and consultants; litigation, regulatory investigations, prosecutions, and other actions, and other potential liabilities. If any of these events occurs, or is believed to occur, our reputation and brand could be damaged, our business may suffer, we could be required to expend significant capital and other resources to alleviate problems caused by such actual or perceived breaches, we could be exposed to a risk of loss, litigation or regulatory action and possible liability, and our ability to operate our business, including our ability to provide access, usage or maintenance and support services to our customers, may be impaired. If current or prospective employer clients or employee participants believe that our systems and solutions do not provide adequate security for the storage of personal or other sensitive information or its transmission over the Internet, our business and our financial results could be harmed. Additionally, actual, potential or anticipated attacks may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees and engage third-party experts and consultants.

Although we maintain privacy, data breach and network security liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. Any actual or perceived compromise or breach of our security measures, or those of our service providers, or any unauthorized access to, misuse or misappropriation of consumer information or other confidential business information, could violate applicable laws and regulations, contractual obligations or other legal obligations and cause significant legal and financial exposure, adverse publicity and a loss of confidence in our security measures, any of which could have an material adverse effect on our business, financial condition and operating results.

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Our business is subject to a variety of laws and regulations, including those regarding privacy, data protection and information security, and our customers, channel partners and service providers are subject to regulations related to the handling and transfer of certain types of sensitive and confidential information and any failure of our infrastructure, our platform, third-party platforms that we utilize, or solutions to comply with or enable our customers, channel partners and service providers to comply with applicable laws and regulations would harm our business, financial condition and operating results.

As part of our business, we collect employee participants' personal data for the sole purpose of processing their benefits. Our services and solutions are subject to privacy- and data protection-related laws and regulations that impose obligations in connection with the collection, processing and use of personal data, financial data, health data or other similar data. Among other things, we have access to, and our employer clients and employee participants are able to use our solutions to handle and transfer, personally identifiable information and other data of our current and prospective employee participants and others. The U.S. federal and various state and other jurisdictional governments have adopted or proposed limitations on, or requirements regarding, the collection, distribution, use, security and storage of personally identifiable information and other data, and the Federal Trade Commission and numerous state attorneys general are applying federal and state consumer protection laws to impose standards on the online collection, use and dissemination of data, and to the security measures applied to such data. In addition, we may find it necessary or desirable to join industry or other self-regulatory bodies or other privacy- or data protection-related organizations that require compliance with their rules pertaining to privacy and data protection. We are also bound by contractual obligations relating to our collection, use and disclosure of personal, financial and other data. Although we comply with applicable laws, regulations, industry standards, contractual obligations and other legal obligations that apply to us, these are constantly evolving and may be modified, may be interpreted and applied in an inconsistent manner from one jurisdiction to another, and may conflict with one another, other requirements or legal obligations or our practices.

In addition, various federal, state and other legislative or regulatory bodies have in place and may enact new or additional laws and regulations mandating certain disclosures, including disclosures of personally identifiable information, to domestic enforcement bodies, which could adversely impact our business, our brand or our reputation with employer clients and employee participants. Despite our efforts to protect customer data, perceptions that the privacy of personal information is not satisfactorily protected in connection with our products or services could inhibit sales of our products or services, could limit adoption of our services by consumers, businesses, and government entities, and could expose us to claims or litigation. Additional privacy- or data security-related measures we may take to address such customer concerns, constraints on our flexibility to determine how to respond to customer expectations or governmental rules or actions, or costs associated with compliance with law enforcement or other regulatory authority demands or requests may adversely affect our business and operating results.

Any failure or perceived failure by us to comply with applicable laws, regulations, policies, industry standards, contractual obligations or other legal obligations relating to privacy or data security, or any security incident that results in the unauthorized access to, or acquisition, release or transfer of, personally identifiable information or other customer data may result in governmental or regulatory investigations, inquiries, enforcement actions and prosecutions, private litigation, fines and penalties or adverse publicity and could cause our employer clients, employee participants, and others to lose trust in us, which could have an adverse effect on our reputation, business, financial condition and results of operations.

Our services and solutions are subject to numerous laws and regulations related to the privacy and security of personal health information, including those promulgated pursuant to the Health Insurance Portability and Accountability Act of 1996, or HIPAA, as well as the Health Information Technology for Economic and Clinical Health Act, or HITECH, which was enacted as part of the American Recovery and Reinvestment Act of 2009, which require the implementation of administrative, physical and technological safeguards to ensure the confidentiality and integrity of individually identifiable health information in electronic form. Further, our services and solutions are subject to Payment Card Industry, or PCI, data security standards that impose requirements regarding the storage and processing of payment card information. If we cannot comply with, or if we incur a violation of, any of these obligations, we could incur significant liability or our growth could be adversely impacted, either of which could have an adverse effect on our reputation, business, financial condition and operating results.

We expect that there will continue to be new proposed laws, regulations, industry standards, contractual obligations and other obligations concerning privacy, data protection and information security and we cannot yet determine the impact of such future laws, regulations, standards and obligations may have on our business. Future laws, regulations, standards and other obligations, or changed interpretations of the foregoing, could, for example, impair our ability to collect, use or store information that we utilize to provide our services, thereby impairing our ability to maintain and grow our total customer base and increase revenues. New laws, amendments to or re-interpretations of existing laws and regulations, industry standards, contractual obligations and other obligations may impact our business and practices. We may be required to expend significant resources to modify our solutions and otherwise adapt to these changes, which we may be unable to do on commercially reasonable terms or at all, and our ability to develop new solutions and features could be limited. These developments could harm our business, financial condition and results of operations.

Any such new laws, regulations, industry standards, or other legal obligations or any changed interpretation of existing laws, regulations, industry standards, or other obligations may require us to incur additional costs and restrict our business operations. If our privacy or data security measures fail to comply with current or future laws, regulations, policies, legal obligations or industry standards, or any changed interpretations of the foregoing, we may be subject to litigation, regulatory investigations, enforcement actions, inquiries, prosecutions, fines or other liabilities, as well as negative publicity and a potential loss of business. Moreover, if future laws, regulations, industry standards, or other legal obligations, or any changed interpretations of the foregoing, limit the ability of our customers, channel partners or service providers to use and share personally identifiable information or other data or our ability to store, process and share personally identifiable information or other data, demand for our solutions could decrease, our costs could increase and our business, financial condition and operating results could be harmed.

A breach of our IT security, loss of customer data or system disruption could have a material adverse effect on our results of operations, business or financial condition and reputation.

Our business is dependent on our transaction, financial, accounting and other data processing systems, as well as instances of third-party service provider systems that we use to provide our services. We rely on these systems to process, on a daily basis, a large number of complicated transactions. Any security breach in our business processes and/or systems, or those third-party systems that we use, has the potential to impact our customer information and our financial reporting capabilities which could result in the potential loss of business and our ability to accurately report information. If any of these systems fail to operate properly or become disabled even for a brief period of time, we could potentially lose control of customer data and we could suffer financial loss, a disruption of our businesses, liability to clients, regulatory intervention or damage to our reputation. In addition, any issue of data privacy as it relates to unauthorized access to or loss of employer client and/or employee participant information could result in the potential loss of business, damage to our market reputation, litigation and regulatory investigation and penalties. Our continued investment in the security of our IT systems, continued efforts to improve the controls within our IT systems and those of any service providers that we use to provide our services, business processes improvements, and the enhancements to our culture of information security may not successfully prevent attempts to breach our security or unauthorized access to confidential, sensitive or proprietary information.

In addition, we depend on information technology networks and systems to collect, process, transmit and store electronic information and to communicate among our locations and with our channel partners, service providers, employer clients and employee participants. Security breaches could lead to shutdowns or disruptions of our systems and potential unauthorized disclosure of confidential information. We also are required at times to manage, utilize and store sensitive or confidential employer client and employee participant data, as well as our own employee data in the regular course of business. As a result, we are subject to numerous laws and regulations designed to protect this information, including various U.S. federal and state laws governing the protection of health or other individually identifiable information, all of which are further described in our Annual Report on Form 10-K under the heading "Business — Government Regulation". If any person, including any of our personnel, fails to comply with, disregards or intentionally breaches our established controls with respect to such data or otherwise mismanages or misappropriates that data, we could be subject to monetary damages, fines or criminal prosecution. Unauthorized disclosure of sensitive or confidential data, whether through systems failure, accident, employee negligence, fraud or misappropriation, could damage our reputation and cause us to lose customers. Similarly, unauthorized access to or through our information systems or those we develop or utilize in connection with our provision of services, whether by our personnel or third parties, could result in significant additional expenses (including expenses relating to notification of data security breaches and costs of credit monitoring services), negative publicity, legal liability and damage to our reputation, as well as require substantial resources and effort of management, thereby diverting management's focus and resources from business operations.

Our inability to successfully recover should we experience a disaster or other business continuity problem could cause material financial loss, loss of human capital, breach of confidential information, regulatory actions, reputational harm or legal liability.

Should we experience a disaster or other business continuity problem, either natural or man-made, our ability to protect our infrastructure, including customer data, and maintain ongoing operations will depend, in part, on the availability of our personnel, our office facilities, and the proper functioning of our computer, telecommunication and other related systems and operations. In such an event, we could experience near-term operational challenges with regard to particular areas of our operations.

In particular, our ability to recover from any disaster or other business continuity problem will depend on our ability to protect our technology infrastructure against damage from business continuity events that could have a significant disruptive effect on our operations. Our business continuity plan may not be successful in mitigating the effects of a disaster or other business continuity problem. We could potentially lose client data, experience a breach of security or confidential information, or experience material adverse interruptions to our operations or delivery of services to our clients in a disaster.

We will continue to regularly assess and take steps to improve upon our business continuity plans. However, a disaster on a significant scale or affecting certain of our key operating areas within or across regions, or our inability to successfully recover should we experience a disaster or other business continuity problem, could materially interrupt our business operations and cause material financial loss, loss of human capital, breach of confidential information, regulatory actions, reputational harm, damaged client relationships and legal liability.

If we fail to effectively upgrade our information technology systems, our business and operations could be disrupted.

As part of our efforts to continue the improvement of our enterprise resource planning, we plan to upgrade our existing information technology systems in order to automate several controls that are currently performed manually. We may experience difficulties in transitioning to these upgraded systems, including loss of data and decreases in productivity as personnel work to become familiar with these new systems. In addition, our management information systems will require modification and refinement as we grow and as our business needs change, which could prolong difficulties we experience with systems transitions, and we may not always employ the most effective systems for our purposes. If we experience difficulties in implementing new or upgraded information systems or experience significant system failures, or if we are unable to successfully modify our management information systems or respond to changes in our business needs, we may not be able to effectively manage our business and we may fail to meet our reporting obligations.

Our future success depends on our ability to recruit and retain qualified employees, including our executive officers and directors.

Our success is substantially dependent upon the performance of our senior management, such as our chief executive officer. Our management and employees may terminate their employment at any time, and the loss of the services of any of our executive officers could materially adversely affect our business. Our success is also substantially dependent upon our ability to attract additional personnel for all areas of our organization. Competition for qualified personnel is intense, and we may not be successful in attracting and retaining such personnel on a timely basis, on competitive terms or at all. Additionally, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as our executive officers due to potential liability concerns related to serving on a public company. If we are unable to attract and retain the necessary personnel, our results of operations, financial condition, business and prospects would be materially adversely affected.

Changes in credit card association or other network rules or standards set by Visa or MasterCard, or changes in card association and debit network fees or products or interchange rates, could materially adversely affect our results of operations, business and financial position.

We, and the banks that issue our prepaid debit cards, are subject to Visa and MasterCard association rules that could subject us to a variety of fines or penalties that may be levied by the card associations or networks for acts or omissions by us or businesses that work with us, including card processors, such as Alegeus. The termination of the card association registrations held by us or any of the banks that issue our cards, or any changes in card association or other debit network rules or standards, including interpretation and implementation of existing rules, participants deciding to use PIN networks, standards or guidance that increase the cost of doing business or limit our ability to provide our products and services, or limit our ability to receive interchange, could have a material adverse effect on our results of operations, financial condition, business and prospects. In addition, from time-to-time, card associations increase the organization or processing fees that they charge, which could increase our operating expenses, reduce our profit margin and materially adversely affect our results of operations, financial condition, business and prospects.

We have entered into outsourcing and other agreements with third parties related to certain of our business operations, and any difficulties experienced in these arrangements could result in additional expense, loss of revenue or an interruption of our services.

We have entered into outsourcing agreements with third parties to provide certain customer service and related support functions to our employer clients and their employee participants. As a result, we rely on third parties over which we have limited control. If these third parties are unable to perform to our requirements or to provide the level of service required or expected by our employer clients, including ensuring the privacy and integrity of individually identifiable health information that they may be privy to as a result of the services they perform for our employer clients and their employee participants, our operating results, financial condition, business, prospects and reputation may be materially harmed. In addition, we may be forced to pursue alternative strategies to provide these services, which could result in delays, interruptions, additional expenses and loss of clients and related revenues.

If our intellectual property and technology are not adequately protected to prevent use or appropriation by our competitors, our business and competitive position could be materially adversely affected.

We rely on a combination of copyright, trademark and trade secret laws, as well as confidentiality procedures and contractual provisions, to establish and protect our intellectual property rights in the United States.

The efforts we have taken to protect our intellectual property may not be sufficient or effective, and our trademarks and copyrights may be held invalid or unenforceable. We may not be effective in policing unauthorized use of our intellectual property, and even if we do detect violations, litigation may be necessary to enforce our intellectual property rights. Any enforcement efforts we undertake, including litigation, could be time consuming and expensive, could divert our management's attention and may result in a court determining that our intellectual property rights are unenforceable. If we are not successful in cost-effectively protecting our intellectual property rights, our results of operations, financial condition, business and prospects could be materially adversely affected.

Our ability to use net operating loss carryforwards to offset future taxable income may be limited.

As of December 31, 2014, we had $38.5 million of federal and $47.0 million of state net operating loss carryforwards available to offset future taxable income. The state net operating loss carryforward is on the post-apportionment basis. These net operating loss carryforwards will expire beginning in 2024 through 2033 for U.S. federal income tax purposes and beginning in 2018 through 2033 for state income tax purposes, if not fully utilized. In addition, we have federal and state research and development credit carryforwards of approximately $4.7 million and $2.4 million, respectively. The federal research credit carryforwards expire beginning in 2022 through 2034, if not fully utilized. The California research credit carries forward indefinitely. Our ability to utilize net operating loss and tax credit carryforwards are subject to restrictions, including limitations in the event of past or future ownership changes as defined in Section 382 of the Internal Revenue Code ("IRC") of 1986, as amended, and similar state tax law. In general, an ownership change occurs if the aggregate stock ownership of certain stockholders increases by more than 50 percentage points over such stockholders' lowest percentage ownership during the testing period (generally three years). We have considered Section 382 of the IRC and concluded that any ownership change would not diminish our utilization of our net operating loss or our research and development credits during the carryover periods.

If one or more jurisdictions successfully assert that we should have collected or in the future should collect additional sales and use taxes on our fees, we could be subject to additional liability with respect to past or future sales and the results of our operations could be adversely affected.

Sales and use tax laws and rates vary by jurisdiction and such laws are subject to interpretation. In those jurisdictions where we believe sales taxes are applicable, we collect and file timely sales tax returns. Currently, such taxes are minimal. Jurisdictions in which we do not collect sales and use taxes may assert that such taxes are applicable, which could result in the assessment of such taxes, interest and penalties, and we could be required to collect such taxes in the future. This additional sales and use tax liability could adversely affect our results of operations.

Third parties may assert intellectual property infringement claims against us, or our services may infringe the intellectual property rights of third parties, which may subject us to legal liability and materially adversely affect our reputation.

Assertion of intellectual property infringement claims against us could result in litigation. We might not prevail in any such litigation or be able to obtain a license for the use of any infringed intellectual property from a third party on commercially reasonable terms, or at all. Even if obtained, we may be unable to protect such licenses from infringement or misuse, or prevent infringement claims against us in connection with our licensing efforts. Any such claims, regardless of their merit or ultimate outcome, could result in substantial cost to us, divert management's attention and our resources away from our operations and otherwise adversely affect our reputation. Our process for controlling our own employees' use of third-party proprietary information may not be sufficient to prevent assertions of intellectual property infringement claims against us.

We rely on insurance to mitigate some risks of our business and, to the extent the cost of insurance increases or we maintain insufficient coverage, our results of operations, business and financial condition may be materially adversely affected.

We contract for insurance to cover a portion of our potential business risks and liabilities. In the current environment, insurance companies are increasingly specific about what they will and will not insure. It is possible that we may not be able to obtain sufficient insurance to meet our needs, may have to pay very high prices for the coverage we do obtain or may not acquire any insurance for certain types of business risks. This could leave us exposed, and to the extent we incur liabilities and expenses for which we are not adequately insured, our results of operations, business and financial condition could be materially adversely affected. Also, to the

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extent the cost of maintaining insurance increases, our operating expenses will rise, which could materially adversely affect our results of operations, financial condition, business and prospects.

In the past significant deficiencies in our internal control over financial reporting have been identified. If our internal controls are not effective, there may be errors in our financial information that could require a restatement or delay our SEC filings, and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

We have, in the past, experienced issues with our internal control over financial reporting and it is possible that we may discover significant deficiencies or material weaknesses in our internal control over financial reporting in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could cause us to fail to meet our periodic reporting obligations, or result in material misstatements in our financial information. Any such delays or restatements could cause investors to lose confidence in our reported financial information and lead to a decline in our stock price.

Substantial sales of our common stock by our stockholders could depress the market price of our common stock regardless of our operating results.

Sales of substantial amounts of our common stock in the public market, or the perception that these sales could occur, could adversely affect the market price of our common stock and impair our ability to raise capital through offerings of our common stock. As of March 31, 2015, we had 35,724,973 shares of our common stock outstanding. In addition, as of March 31, 2015, there were outstanding options to purchase 3,013,180 shares of our common stock and 787,436 restricted stock units. Substantially all of our outstanding common stock is eligible for sale, subject to Rule 144 volume limitations for holders affected by such limitations, as are common stock issuable under vested and exercisable options. If our existing stockholders sell a large number of common stock or the public market perceives that existing stockholders might sell our common stock, the market price of our common stock could decline significantly. These sales might also make it more difficult for us to sell equity securities at a time and price that we deem appropriate.

Our stock price has fluctuated and may continue to do so and may even decline regardless of our financial performance.

The market price of our common stock has fluctuated and may continue to fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our financial results;
- the financial projections we provide to the public, any changes in these projections or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in operating performance and stock market valuations of other newly public companies generally, or those in our industry in particular;
- changes brought about by health care reform and the emergence of federal, state and private exchanges;
- price and volume fluctuations in the overall stock market, including as a result of trends in the global economy;
- any major change in our board of directors or management;
- lawsuits threatened or filed against us; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against such a company. If securities class action litigation is instituted against us, it could result in substantial costs and a diversion of our management's attention and resources and could materially adversely affect our operating results.

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Anti-takeover provisions contained in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation, amended and restated bylaws and Delaware law contain provisions that could have the effect of delaying, preventing or rendering more difficult an acquisition of us if such acquisition is deemed undesirable by our board of directors. Our corporate governance documents include provisions that:

- create a classified board of directors whose members serve staggered three-year terms;
- authorize “blank check” preferred stock, which could be issued by the board of directors without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- limit the ability of our stockholders to call and bring business before special meetings;
- require advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- control the procedures for the conduct and scheduling of board of directors and stockholder meetings; and
- provide the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

These provisions, alone or together, could delay or prevent unsolicited takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock.

Any provision of our amended and restated certificate of incorporation or amended and restated bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock and could also affect the price that some investors are willing to pay for our common stock.

We do not expect to declare any dividends in the foreseeable future.

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future. In addition, our existing credit facility prohibits us from paying cash dividends, and any future financing agreements may prohibit us from paying any type of dividends. Consequently, investors may need to rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

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

Unregistered Sales of Equity Securities

None.

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report.

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SIGNATURES

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

		WAGEWORKS, INC.
Date: May 5, 2015	By:	/s/ Colm Callan Colm Callan Chief Financial Officer (Principal Financial Officer)
		/s/ Colm Callan Colm Callan Chief Financial Officer (Principal Accounting Officer)

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Exhibit Index

Exhibit No.	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.1	Lease Agreement by and between Park Place Realty Holding Company, Inc. and Registrant, dated as of April 10, 2014					X
10.2	Second Amendment to lease, by and between Potawatomi Properties, L.L.C. and Registrant, dated as of February 9, 2015					X
10.3	Lease Agreement by and between Freeport 9 Office Center, L.P. and Registrant, dated as of March 25, 2015					X
31.1	Certification of the Principal Executive Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of the Principal Financial Officer Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1(1)	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101.INS	XBRL Instance Document					
101.SCH	XBRL Taxonomy Schema Linkbase Document					
101.CAL	XBRL Taxonomy Calculation Linkbase Document					
101.DEF	XBRL Taxonomy Definition Linkbase Document					
101.LAB	XBRL Taxonomy Labels Linkbase Document					
101.PRE	XBRL Taxonomy Presentation Linkbase Document					

(1) The information in this exhibit is furnished and deemed not filed with the Securities and Exchange Commission for purposes of section 18 of the Exchange Act of 1934, as amended (the “Exchange Act”), and is not to be incorporated by reference into any filing of WageWorks, Inc. under the Securities Act of 1933, as amended (the “Securities Act”), or the Exchange Act, whether made before or after the date hereof, regardless of any general incorporation language in such filing.