

**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 September 30, 2020

or

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

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

Commission File Number: 001-36061

**Benefitfocus, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**46-2346314**

(I.R.S. Employer  
Identification No.)

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.001 Par Value	BNFT	Nasdaq Global Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

- Large accelerated filer                       Accelerated filer                       Non-accelerated filer  
 Smaller reporting company                       Emerging growth company

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

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

As of November 6, 2020, there were approximately 32,201,280 shares of the registrant's common stock outstanding.

Benefitfocus, Inc.

Form 10-Q

For the Quarterly Period Ended September 30, 2020

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	As of September 30, 2020	As of December 31, 2019
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 108,240	\$ 130,976
Marketable securities	67,807	–
Accounts receivable, net	29,899	33,754
Contract, prepaid and other current assets	14,021	21,523
Total current assets	219,967	186,253
Property and equipment, net	30,502	28,669
Financing lease right-of-use assets	70,970	78,520
Operating lease right-of-use assets	1,467	1,715
Intangible assets, net	10,962	12,667
Goodwill	12,857	12,857
Deferred contract costs and other non-current assets	9,987	11,002
Total assets	<u>\$ 356,712</u>	<u>\$ 331,683</u>
<b>Liabilities and stockholders' deficit</b>		
Current liabilities:		
Accounts payable	\$ 2,475	\$ 9,563
Accrued expenses	8,116	10,526
Accrued compensation and benefits	15,736	15,246
Deferred revenue, current portion	28,239	33,429
Lease liabilities and financing obligations, current portion	6,297	6,871
Total current liabilities	60,863	75,635
Deferred revenue, net of current portion	4,543	5,079
Convertible senior notes	181,486	187,949
Lease liabilities and financing obligations, net current portion	80,885	88,572
Other non-current liabilities	3,582	92
Total liabilities	<u>331,359</u>	<u>357,327</u>
Commitments and contingencies		
Redeemable preferred stock:		
Series A preferred stock, par value \$0.001, 5,000,000 shares authorized, 1,777,778 and 0 shares issued and outstanding at September 30, 2020 and December 31, 2019, respectively, liquidation preference \$45 per share as of September 30, 2020	79,193	–
Stockholders' deficit:		
Common stock, par value \$0.001, 50,000,000 shares authorized, 32,288,044 and 32,788,980 shares issued and outstanding at September 30, 2020 and December 31, 2019, respectively	32	33
Additional paid-in capital	425,283	426,025
Accumulated deficit	(479,155)	(451,702)
Total stockholders' deficit	<u>(53,840)</u>	<u>(25,644)</u>
Total liabilities, redeemable preferred stock and stockholders' deficit	<u>\$ 356,712</u>	<u>\$ 331,683</u>

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue	\$ 63,583	\$ 71,665	\$ 191,911	\$ 208,543
Cost of revenue	30,113	35,588	94,422	101,242
Gross profit	33,470	36,077	97,489	107,301
Operating expenses:				
Sales and marketing	12,405	18,527	39,863	57,464
Research and development	11,439	14,088	34,252	41,639
General and administrative	9,424	10,772	29,320	34,353
Restructuring costs	-	-	5,616	-
Total operating expenses	33,268	43,387	109,051	133,456
Income (loss) from operations	202	(7,310)	(11,562)	(26,155)
Other income (expense):				
Interest income	40	673	563	2,095
Interest expense	(5,771)	(5,926)	(17,524)	(17,577)
Gain on repurchase of convertible senior notes	1,138	-	1,138	-
Other income (expense)	1	3	8	(61)
Total other expense, net	(4,592)	(5,250)	(15,815)	(15,543)
Loss before income taxes	(4,390)	(12,560)	(27,377)	(41,698)
Income tax expense	6	17	17	26
Net loss	(4,396)	(12,577)	(27,394)	(41,724)
Preferred dividends	(1,600)	-	(2,062)	-
Net loss available to common stockholders	\$ (5,996)	\$ (12,577)	\$ (29,456)	\$ (41,724)
Comprehensive loss	\$ (5,996)	\$ (12,577)	\$ (29,456)	\$ (41,724)
Net loss per common share:				
Basic and diluted	\$ (0.19)	\$ (0.38)	\$ (0.91)	\$ (1.29)
Weighted-average common shares outstanding:				
Basic and diluted	32,263,876	32,703,723	32,320,201	32,460,494

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

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

	Common Stock, \$0.001 Par Value		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Par Value			
Balance, December 31, 2019	32,788,980	\$ 33	\$ 426,025	\$ (451,702)	\$ (25,644)
Cumulative effect adjustment from adoption of credit standard	-	-	-	(59)	(59)
Exercise of stock options	13,584	-	73	-	73
Issuance of common stock upon vesting of restricted stock units	43,315	-	-	-	-
Stock-based compensation expense	-	-	3,677	-	3,677
Common stock repurchased	(1,070,665)	(1)	(9,382)	-	(9,383)
Net loss	-	-	-	(11,136)	(11,136)
Balance, March 31, 2020	31,775,214	\$ 32	\$ 420,393	\$ (462,897)	\$ (42,472)
Exercise of stock options	10,685	-	69	-	69
Issuance of common stock upon vesting of restricted stock units	416,848	-	-	-	-
Issuance of common stock under Employee Stock Purchase Plan, or ESPP	8,205	-	83	-	83
Stock-based compensation expense	-	-	3,323	-	3,323
Common stock repurchased	(35,508)	-	(284)	-	(284)
Preferred dividends	-	-	(462)	-	(462)
Net loss	-	-	-	(11,862)	(11,862)
Balance, June 30, 2020	32,175,444	\$ 32	\$ 423,122	\$ (474,759)	\$ (51,605)
Exercise of stock options	38,000	-	288	-	288
Issuance of common stock upon vesting of restricted stock units	78,251	-	-	-	-
Cancellation of convertible senior note capped call hedge	(3,651)	-	26	-	26
Equity component of repurchased convertible senior notes	-	-	(412)	-	(412)
Stock-based compensation expense	-	-	3,859	-	3,859
Preferred dividends	-	-	(1,600)	-	(1,600)
Net loss	-	-	-	(4,396)	(4,396)
Balance, September 30, 2020	32,288,044	\$ 32	\$ 425,283	\$ (479,155)	\$ (53,840)

	Common Stock, \$0.001 Par Value		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Par Value			
Balance, December 31, 2018	32,017,773	\$ 32	\$ 403,631	\$ (413,873)	\$ (10,210)
Cumulative effect adjustment from adoption of lease standard	-	-	-	7,687	7,687
Exercise of stock options	18,600	-	89	-	89
Issuance of common stock upon vesting of restricted stock units	34,255	-	-	-	-
Stock-based compensation expense	-	-	6,253	-	6,253
Net loss	-	-	-	(14,209)	(14,209)
Balance, March 31, 2019	32,070,628	\$ 32	\$ 409,973	\$ (420,395)	\$ (10,390)
Exercise of stock options	6,200	-	45	-	45
Issuance of common stock upon vesting of restricted stock units	565,878	1	-	-	1
Stock-based compensation expense	-	-	6,203	-	6,203
Net loss	-	-	-	(14,938)	(14,938)
Balance, June 30, 2019	32,642,706	\$ 33	\$ 416,221	\$ (435,333)	\$ (19,079)
Issuance of common stock upon vesting of restricted stock units	60,676	-	-	-	-
Issuance of common stock under ESPP	6,650	-	172	-	172
Stock-based compensation expense	-	-	4,415	-	4,415

Net loss	-	-	-	(12,577)	(12,577)
Balance, September 30, 2019	<u>32,710,032</u>	<u>\$ 33</u>	<u>\$ 420,808</u>	<u>\$ (447,910)</u>	<u>\$ (27,069)</u>

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

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

	Nine Months Ended September 30,	
	2020	2019
<b>Cash flows from operating activities</b>		
Net loss	\$ (27,394)	\$ (41,724)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	18,479	16,629
Stock-based compensation expense	10,859	14,501
Accretion of interest on convertible senior notes	8,834	8,377
Interest accrual on finance lease liabilities	71	25
Rent expense less than payments	(24)	(6)
Non-cash interest income for short-term investments	16	-
Gain on extinguishment of debt	(1,138)	-
Provision for doubtful accounts	111	108
Changes in operating assets and liabilities:		
Accounts receivable, net	3,685	(12,791)
Accrued interest on short-term investments	(38)	-
Contract, prepaid and other current assets	7,502	1,282
Deferred costs and other non-current assets	1,014	3,746
Accounts payable and accrued expenses	(9,157)	(642)
Accrued compensation and benefits	490	(1,524)
Deferred revenue	(5,726)	(11,427)
Other non-current liabilities	3,490	(69)
Net cash and cash equivalents provided by (used in) operating activities	<u>11,074</u>	<u>(23,515)</u>
<b>Cash flows from investing activities</b>		
Purchases of short term investments held to maturity	(67,785)	-
Business combination, net of cash acquired	-	(20,914)
Purchases of property and equipment	(9,739)	(10,604)
Net cash and cash equivalents used in investing activities	<u>(77,524)</u>	<u>(31,518)</u>
<b>Cash flows from financing activities</b>		
Draws on revolving line of credit	10,000	-
Payments on revolving line of credit	(10,000)	-
Repurchase of convertible senior notes	(14,619)	-
Payments of debt issuance costs	(154)	(357)
Cancellation of convertible senior notes capped call hedge	26	-
Proceeds from issuance of preferred stock, net of issuance costs	79,192	-
Payments of preferred dividends	(2,062)	-
Repurchase of common stock	(9,667)	-
Proceeds from exercises of stock options and ESPP	513	305
Payments on financing obligations	(635)	(1,032)
Payments of principal on finance lease liabilities	(8,880)	(4,112)
Net cash and cash equivalents provided by (used in) financing activities	<u>43,714</u>	<u>(5,196)</u>
<b>Net decrease in cash and cash equivalents</b>	<u>(22,736)</u>	<u>(60,229)</u>
Cash and cash equivalents, beginning of period	130,976	190,928
<b>Cash and cash equivalents, end of period</b>	<u>\$ 108,240</u>	<u>\$ 130,699</u>
<b>Supplemental disclosure of non-cash investing and financing activities</b>		
Property and equipment purchases in accounts payable and accrued expenses	<u>\$ —</u>	<u>\$ —</u>

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

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

**1. Organization and Description of Business**

Benefitfocus, Inc. (the "Company") provides a leading cloud-based benefits management platform for consumers, employers, insurance carriers and brokers that is designed to simplify how organizations and individuals transact benefits. The financial statements of the Company include the financial position and operations of its wholly owned subsidiaries, Benefitfocus.com, Inc. and BenefitStore, Inc.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation***

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

***Interim Unaudited Consolidated Financial Information***

The accompanying unaudited consolidated financial statements and footnotes have been prepared in accordance with GAAP as contained in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification (the "Codification" or "ASC") for interim financial information, and with Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the results of operations, financial position, changes in stockholders' deficit and cash flows. The results of operations for the three- and nine-month periods ended September 30, 2020 are not necessarily indicative of the results for the full year or for any other future period. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related footnotes for the year ended December 31, 2019 included in the Company's Annual Report on Form 10-K.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Such estimates include allowances for doubtful accounts and returns, valuations of deferred income taxes, long-lived assets, capitalizable software development costs and the related amortization, incremental borrowing rate used in lease accounting, the determination of the useful lives of assets, and the impairment assessment of acquired intangibles and goodwill. Additionally as described in revenue and deferred revenue below, estimates are utilized in association with revenue recognition, in particular the estimation of variable consideration using the expected value method from insurance broker commissions reported in Platform revenue. Determination of these transactions and account balances are based on, among other things, the Company's estimates and judgments. These estimates are based on the Company's knowledge of current events and actions it may undertake in the future as well as on various other assumptions that it believes to be reasonable. Actual results could differ materially from these estimates.

***Restructuring Costs***

On April 28, 2020, the Company announced a restructuring plan to contain costs and further strengthen its liquidity profile in response to the impact of the COVID-19 pandemic. This plan resulted in a reduction in the Company's U.S. workforce of approximately 17%. The Company recorded restructuring costs of \$5,616 in the second quarter of 2020 from one-time severance charges, continuation of health benefits and outplacement services. Restructuring costs are presented separately in operating expenses in the unaudited consolidated statements of operations and comprehensive loss. The plan was implemented and completed in the second quarter of 2020.

***Revenue and Deferred Revenue***

The Company derives its revenue primarily from fees for subscription services and professional services sold to employers and insurance carriers as well as platform revenue derived from the value of products sold on our platform. Revenue is recognized when control of these services is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services. Taxes collected from customers relating to services and remitted to governmental authorities are excluded from revenue.

The Company determines revenue recognition through the following steps:

- Identification of each contract with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;

- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, performance obligations are satisfied.

#### *Software Services Revenue*

Software services revenue consists of subscription revenue and platform revenue.

#### *Subscription Revenue*

Subscription revenue primarily consists of monthly subscription fees paid to the Company by its employer and insurance carrier customers for access to, and usage of, cloud-based benefits software solutions for a specified contract term. Fees are generally charged based on the number of employees or subscribers with access to the solution.

Subscription services revenue is generally recognized on a ratable basis over the contract term beginning on the date the subscription services are made available to the customer. The Company's subscription service contracts are generally three years.

Subscription revenue also includes fees paid for other services, such as event sponsorships and certain data services.

#### *Platform Revenue*

Platform revenue is generated from the value of policies or products enrolled in through the Company's marketplace. Platform revenue from carriers is generally recognized over the policy period of the enrolled products. In arrangements where the Company sells policies to employees of its customers as the broker, it earns broker commissions. Revenue from insurance broker commissions and supplier transactions is recognized at a point in time when the orders for the policies are received and transferred to the insurance carrier or supplier, and is reduced by constraints for variable consideration associated with collectability, policy cancellation and termination risks.

#### *Professional Services Revenue*

Professional services revenue primarily consists of fees related to the implementation of software products purchased by customers. Professional services typically include discovery, configuration and deployment, integration, testing, and training. Fees from consulting services and support services are also included in professional services revenue.

The Company determined that implementation services for certain of its insurance carrier customers significantly modify or customize the software solution and, as such, do not represent a distinct performance obligation. Accordingly, revenue from such implementation services with these insurance carrier customers are generally recognized over the contract term of the associated subscription services contract, including any extension periods representing a material right. In certain arrangements, the Company utilizes estimates of hours as a measure of progress to determine revenue.

Revenue from implementation services with employer customers is generally recognized as those services are performed.

Revenue from support and training fees is recognized over the service period.

#### *Contracts with Multiple Performance Obligations*

Certain of the Company's contracts with customers contain multiple performance obligations. For these contracts, the individual performance obligations are accounted for separately if they are distinct. The Company allocates the transaction price to the separate performance obligations based on their relative standalone selling prices. The Company determines the standalone selling prices based on its overall pricing objectives, taking into consideration market conditions and other factors, including the value of its contracts, the subscription services sold, customer size and complexity, and the number and types of users under the contracts.

#### **Contract Costs**

The Company capitalizes costs to obtain contracts that are considered incremental and recoverable, such as sales commissions. Payments of sales commissions generally include multiple payments. The Company capitalizes only those payments made within an insignificant time from the contract inception, typically three months or less. Subsequent payments are expensed as incurred. The capitalized costs are amortized to sales and marketing expense over the estimated period of benefit of the asset, which is generally four to five years. The Company expenses the costs to obtain a contract when the amortization period is less than one year. Deferred costs related to obtaining contracts are included in deferred contract costs and other non-current assets.

The Company capitalizes contract fulfillment costs directly associated with customer contracts that are not related to satisfying performance obligations. The costs are amortized to cost of revenue expense over the estimated period of benefit, which is generally five years. Deferred fulfillment costs are included in deferred contract costs and other non-current assets.

The following tables present information about deferred contract costs:

	As of September 30, 2020	As of December 31, 2019
<b>Balance of deferred contract costs</b>		
Costs to obtain contracts	\$ 5,397	\$ 6,676
Costs to fulfill contracts	\$ 3,664	\$ 3,112

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Amortization of deferred contract costs</b>				
Costs to obtain contracts included in sales and marketing expense	\$ 772	\$ 871	\$ 2,484	\$ 2,788
Costs to fulfill contracts included in cost of revenue	\$ 279	\$ 743	\$ 961	\$ 2,347

### Marketable Securities

Marketable securities consist of short-term investments in corporate bonds, commercial paper, and U.S. Treasury and agency bonds. To reflect its intention, the Company classifies its marketable securities as held-to-maturity at the time of purchase. As a result, the marketable securities are recorded at amortized cost and any gains or losses realized upon maturity are reported in other expense, net in the consolidated statements of operations and comprehensive loss.

Debt securities classified as held-to-maturity are subject to the expected credit loss model prescribed under Accounting Standards Update ("ASU") No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments". The Company utilizes a lifetime expected credit loss measurement objective for the recognition of credit losses for held-to-maturity securities at the time the financial asset is originated or acquired. The Company measures expected credit losses on its held-to-maturity portfolio on a collective basis by major security type. The expected credit losses are adjusted each period for changes in expected lifetime credit losses. The Company's credit loss calculations for held-to-maturity securities are based upon historical default and recovery rates of bonds rated with the same rating as its portfolio. An adjustment factor is applied to these credit loss calculations based upon the Company's assessment of the expected impact from current economic conditions on its investments. The Company monitors the credit quality of debt securities classified as held-to-maturity through the use of their respective credit rating and updates them on a quarterly basis. The allowance for credit losses is discussed in Note 5.

### Concentrations of Credit Risk

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

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

To manage accounts receivable risk, the Company evaluates the creditworthiness of its customers and maintains an allowance for doubtful accounts. Accounts receivable are unsecured and derived from revenue earned from customers located in the United States. No customer exceeded 10% of accounts receivable as of September 30, 2020. Accounts receivable from one customer represented approximately 11% of the total accounts receivable as of December 31, 2019. No customer exceeded 10% of total revenue in any of the three and nine-month periods ended September 30, 2020 and 2019.

### Allowance for Doubtful Accounts

Historically, the Company used an incurred loss model to calculate its allowance for doubtful accounts. Upon the adoption of ASU No. 2016-13 on January 1, 2020, the Company shifted to a current expected credit loss model. Accounts receivable and allowance for doubtful accounts are discussed in Note 6.

### Capitalized Software Development Costs

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

The following tables present information about capitalized software development costs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Capitalized software development costs</b>				
Capitalized	\$ 2,627	\$ 2,563	\$ 9,199	\$ 7,246
Amortized	\$ 2,032	\$ 1,263	\$ 5,278	\$ 3,760

	As of September 30, 2020	As of December 31, 2019
<b>Capitalized software development costs</b>		
Net book value	\$ 18,380	\$ 14,459

## Leases

The Company periodically enters into finance leases for property and equipment. The leasing arrangements for the Company's office space at its headquarters campus are classified as finance leases. The Company also leases office space under operating leases.

The Company determines if an arrangement is a lease at inception. Right of use, or ROU, assets represent the Company's right to use an underlying asset for the lease term. Lease liabilities represent an obligation to make lease payments arising from the lease. Leases with a term of 12 months or less are not included in the recognized ROU assets and lease liabilities for all classes of assets.

ROU assets and lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. Because the Company's operating leases do not provide an implicit interest rate, the Company uses its incremental borrowing rate based on information available at commencement date to determine the present value of lease payments. The ROU asset also consists of any prepaid lease payments, lease incentives, or initial direct costs. The lease terms used to calculate the ROU asset and related lease liability include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option.

Lease expense for operating leases is recognized on a straight-line basis over the lease term as an operating expense while the expense for finance leases is recognized as depreciation expense and interest expense. The Company has lease agreements which require payments for lease and non-lease components (e.g. common area maintenance and equipment maintenance) that are accounted for as a single lease component. Variable lease payment amounts that cannot be determined at the commencement of the lease, such as maintenance costs based on future obligations, are not included in the ROU assets or liabilities. These are expensed as incurred and recorded as variable lease expense.

## Comprehensive Loss

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

## Recently Adopted Accounting Standards

### Financial Instruments

On January 1, 2020, the Company adopted ASU No. 2016-13. The purpose of this ASU is to require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. On adoption, the Company recorded an immaterial cumulative-effect adjustment to retained earnings in connection with expected credit losses on its trade receivables.

### Fair Value Measurement

On January 1, 2020, the Company adopted ASU No. 2018-13, "Fair Value Measurement (Topic 820): Changes to the Disclosure Requirements for Fair Value Measurement". The ASU modifies the disclosure requirements required for fair value measurements. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

## Accounting Standards Not Yet Adopted

In August 2020, the FASB issued ASU No. 2020-06, "Debt - Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40)". The update simplifies the accounting for convertible debt instruments and convertible preferred stock by reducing the number of accounting models and the number of embedded conversion features that could be recognized separately from the primary contract. This ASU also enhances transparency and improves disclosures for convertible instruments and earnings per share guidance. It is effective for annual reporting periods beginning after December 15, 2021, including interim periods within those fiscal years. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020. This update permits the use of either the modified retrospective or fully retrospective method of transition. The Company is currently evaluating the timing and impact of the adoption of ASU 2020-06 on the Company's consolidated financial statements but anticipates that it will result in a reduction in non-cash interest expense related to the Convertible Senior Notes.

In December 2019, the FASB issued ASU No. 2019-12, "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes". ASU No. 2019-12 is intended to simplify various aspects related to accounting for income taxes, eliminates certain exceptions to the general principles in ASC Topic 740 related to intra-period tax allocation, simplifies when companies recognize deferred taxes in an interim period, and clarifies certain aspects of the current guidance to promote consistent application. This ASU is effective for the Company for the interim and annual reporting periods starting January 1, 2021. Early adoption is permitted. The Company is currently evaluating the potential effects of this guidance on its consolidated financial statements.

### 3. Net Loss Per Common Share

Diluted loss per common share is the same as basic loss per common share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company's net loss.

The following common share equivalent securities have been excluded from the calculation of weighted average common shares outstanding because the effect is anti-dilutive for the periods presented:

Anti-Dilutive Common Share Equivalents	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Restricted stock units	2,686,057	2,065,629	2,686,057	2,065,629
Stock options	122,178	206,447	122,178	206,447
Convertible senior notes	4,161,182	4,513,824	4,161,182	4,513,824
Conversion of preferred stock	5,333,334	-	5,333,334	-
Employee Stock Purchase Plan	3,117	3,831	3,117	3,831
Total anti-dilutive common share equivalents	<u>12,305,868</u>	<u>6,789,731</u>	<u>12,305,868</u>	<u>6,789,731</u>

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Numerator:				
Net loss	\$ (4,396)	\$ (12,577)	\$ (27,394)	\$ (41,724)
Preferred dividends	(1,600)	-	(2,062)	-
Net loss attributable to common stockholders	<u>\$ (5,996)</u>	<u>\$ (12,577)</u>	<u>\$ (29,456)</u>	<u>\$ (41,724)</u>
Denominator:				
Weighted-average common shares outstanding, basic and diluted	32,263,876	32,703,723	32,320,201	32,460,494
Net loss per common share, basic and diluted	<u>\$ (0.19)</u>	<u>\$ (0.38)</u>	<u>\$ (0.91)</u>	<u>\$ (1.29)</u>

### 4. Fair Value Measurement

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

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

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

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

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

The following tables present information about the Company's assets and liabilities that are measured at fair value on a recurring basis using the above categories, as of the periods presented.

Description	September 30, 2020			
	Level 1	Level 2	Level 3	Total
Cash Equivalents:				
Money market mutual funds <sup>(1)</sup>	\$ 105,123	\$ —	\$ —	\$ 105,123
Total assets	<u>\$ 105,123</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 105,123</u>

Description	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Cash Equivalents:				
Money market mutual funds(1)	\$ 124,503	\$ —	\$ —	\$ 124,503
Total assets	\$ 124,503	\$ —	\$ —	\$ 124,503

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

## 5. Marketable Securities

Marketable securities consist of corporate bonds, commercial paper and U.S. Treasury and agency bonds, and are classified as held-to-maturity. All marketable securities had contractual maturities of less than one year as of September 30, 2020. The following presents information about the Company's marketable securities by major security type as of September 30, 2020. There were no marketable securities as of December 31, 2019.

Sector	As of September 30, 2020					
	Amortized cost	Allowance for credit losses	Net carrying amount	Gross unrealized gains	Gross unrealized losses	Fair value
Industrial	\$ 8,987	\$ -	\$ 8,987	\$ -	\$ -	\$ 8,987
Financial	34,675	-	34,675	-	(3)	34,672
Government	24,145	-	24,145	3	-	24,148
Total	\$ 67,807	\$ -	\$ 67,807	\$ 3	\$ (3)	\$ 67,807

The fair value of marketable securities in the Government major security type is classified as a Level 1 in the Company's fair value hierarchy described in Note 4. The fair values of the remaining major security types are classified as Level 2.

The Company invests in highly rated securities with maturities of two years or less at the time of purchase. Given the credit quality of the financial assets and the historical loss experience associated their respective credit ratings as well as the duration of these financial assets and the short time horizon over which to consider expectations of future economic conditions, the Company has assessed that non-collection of the cost basis of these financial assets is remote.

## 6. Accounts Receivable, net

Accounts receivable, net include:

	As of September 30, 2020	As of December 31, 2019
Accounts receivable	\$ 32,229	\$ 36,669
Less: Allowance for doubtful accounts	(298)	(155)
Less: Allowance for returns	(2,032)	(2,760)
Total accounts receivable, net	\$ 29,899	\$ 33,754

Accounts receivable are stated at their amortized cost adjusted for any write-offs and net allowances for returns. The Company estimates expected credit losses related to accounts receivable balances based on a review of available and relevant information including current economic conditions, projected economic conditions, historical loss experience, account aging, and other factors that could affect collectability. Expected credit losses are determined individually or collectively depending on whether the accounts receivable balances share similar risk characteristics. The allowance for doubtful accounts is the best estimate of the amount of expected credit losses related to existing accounts receivable. The Company does not have any off-balance sheet credit exposure related to its customers.

	Nine Months Ended September 30,
<b>Allowance for doubtful accounts</b>	
Beginning of period	\$ 155
Provision for credit losses (including effect of adoption)	187
Write-offs and recoveries	(44)
End of period	\$ 298

The allowances for returns are accounted for as reductions of revenue and are estimated based on the Company's periodic assessment of historical experience and trends. The Company considers factors such as historical reasons for adjustments, service and delivery issues or delays, and past due customer billings.

## 7. Convertible Senior Notes

In December 2018, the Company issued \$240,000 aggregate principal amount of 1.25% convertible senior notes ("Notes") due December 15, 2023, unless earlier repurchased by the Company or converted by the holder pursuant to their terms. Interest is payable semiannually in arrears on June 15 and December 15 of each year, commencing on June 15, 2019.

The Notes are governed by an Indenture between the Company, as issuer, and U.S. Bank, National Association, as trustee. The Notes are unsecured and rank: senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to the Company's unsecured indebtedness that is not subordinated; effectively junior in right of payment to any of the Company's senior, secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities incurred by the Company's subsidiaries.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of common stock, at the Company's election.

At issuance, the Notes had an initial conversion rate of 18.8076 shares of common stock per \$1 principal amount of Notes, which represented an initial effective conversion price of approximately \$53.17 per share of common stock and 4,513,824 shares issuable upon conversion. Throughout the term of the Notes, the conversion rate may be adjusted upon the occurrence of certain events. Holders of the Notes will not receive any cash payment representing accrued and unpaid interest, if any, upon conversion of a Note, except in limited circumstances. Accrued but unpaid interest will be deemed to be paid by cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock paid or delivered, as the case may be, to the holder upon conversion of Notes.

Prior to the close of business on September 14, 2023, the Notes will be convertible at the option of holders during certain periods, only upon satisfaction of certain conditions set forth below. On or after September 15, 2023, until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their Notes at the conversion price at any time regardless of whether the conditions set forth below have been met.

Holders may convert all or a portion of their Notes prior to the close of business on September 14, 2023, in multiples of \$1 principal amount, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on March 31, 2019 (and only during such calendar quarter), if the last reported sales price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period, or the Notes measurement period, in which the "trading price" (as defined in the Indenture) per \$1 principal amount of notes for each trading day of the Notes measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day;
- if the Company calls any or all of the Notes for redemption, at any time prior to the close of business on September 14, 2023; or
- upon the occurrence of specified corporate events.

As of September 30, 2020, the Notes were not convertible.

Based on market data available for publicly traded, senior, unsecured corporate bonds issued by companies in the same industry and with similar maturity, the Company estimated the implied market interest rate of its Notes to be approximately 7.30%, assuming no conversion option. Assumptions used in the estimate represent what market participants would use in pricing the liability component of the Notes, including market interest rates, credit standing, and yield curves, all of which are defined as Level 2 observable inputs. The estimated implied interest rate was applied to the Notes, which resulted in a fair value of the liability component of \$181,500 upon issuance, calculated as the present value of future contractual payments based on the \$240,000 aggregate principal amount. The excess of the principal amount of the liability component over its carrying amount, or the debt discount, is amortized to interest expense over the term of the Notes. The \$58,500 difference between the gross proceeds received from issuance of the Notes of \$240,000 and the estimated fair value of the liability component represented the equity component of the Notes and was recorded in additional paid-in capital. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, the Company allocated the total amount incurred to the liability and equity components in proportion to the allocation of proceeds. Transaction costs attributable to the liability component, totaling \$4,808, are being amortized to expense over the term of the Notes, and transaction costs attributable to the equity component, totaling \$1,550, and were included with the equity component in shareholders' equity.

During the three months ended September 30, 2020, the Company repurchased Notes with an aggregate principal amount of \$18,750 and carrying value of \$15,346. The Company paid \$14,619 in cash of which \$14,207 was allocated to the liability component of the Notes and \$412 was allocated to the equity component and recorded as an adjustment to additional paid-in capital. The Company recognized a gain on the extinguishment of the liability in the amount of \$1,139 and is presented separately in other income (expense) in the unaudited consolidated statements of operations and comprehensive loss.

The Notes consist of the following as of:

	As of	
	September 30, 2020	December 31, 2019
Liability component:		
Principal	\$ 221,250	\$ 240,000
Less: Debt discount, net of amortization	(39,764)	(52,051)
Net carrying amount	\$ 181,486	\$ 187,949
Equity component (a)	56,539	56,950

(a) Recorded in the consolidated balance sheet within additional paid-in capital, net of \$1,550 transaction costs in equity.

The following table sets forth total interest expense recognized related to the Notes:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
1.25% coupon	\$ 750	\$ 758	\$ 2,250	\$ 2,250
Amortization of debt discount and transaction costs	2,940	2,836	8,834	8,377
	\$ 3,690	\$ 3,594	\$ 11,084	\$ 10,627

As of September 30, 2020, the fair value of the Notes, which was determined based on inputs that are observable in the market or that could be derived from, or corroborated with, observable market data, quoted price of the Notes in an over-the-counter market (Level 2), and carrying value of debt instruments (carrying value excludes the equity component of the Company's Notes classified in equity) were as follows:

	September 30, 2020		December 31, 2019	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Convertible senior notes	\$ 179,766	\$ 181,486	\$ 207,600	\$ 187,949

In connection with the issuance of the Notes, the Company entered into capped call transactions with certain counterparties affiliated with the initial purchasers and others. The capped call transactions are expected to reduce potential dilution of earnings per share upon conversion of the Notes. Under the capped call transactions, the Company purchased capped call options that in the aggregate relate to the total number of shares of the Company's common stock underlying the Notes, with an initial strike price of approximately \$53.17 per share, which corresponds to the initial conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes, and have a cap price of approximately \$89.98. The cost of the purchased capped calls of \$33,024 was recorded to stockholders' deficit and will not be re-measured provided it continues to meet the conditions for equity classification.

In connection with the purchase of the Notes described above, the Company terminated a portion of the capped call transactions which resulted in an immaterial amount of payments to the Company in cash and common stock which was recorded in addition paid-in capital.

Based on the closing price of our common stock of \$11.20 on September 30, 2020, the last trading day of the quarter, the if-converted value of the Notes was less than their respective principal amounts.

## 8. Revolving Line of Credit

The Company entered into a new credit facility with Silicon Valley Bank providing for a revolving line of credit agreement on March 3, 2020. This agreement replaced the Company's previous agreement with Silicon Valley Bank, which expired on February 20, 2020. The three-year agreement has a borrowing limit of \$50,000, with the ability for the Company to increase it to up to \$100,000. Interest is payable monthly. Advances under the agreement bear interest at (a) the higher of (i) the prime rate as published in the Wall Street Journal or (ii) the federal funds effective rate plus 0.50%, plus (b) an applicable margin ranging from (0.50%) to 0.50% based on the Company's Average Daily Usage ("ADU") of the credit facility in the preceding month. The Company also is charged for amounts unused under this arrangement at a rate ranging from 0.00% to 0.40% based on the Company's ADU in the preceding month. Any outstanding principal is due at the end of the term.

The obligations of the Company under the new credit facility are secured by a first priority lien (subject to certain permitted liens) in substantially all of the personal property assets of the Company and its subsidiaries pursuant to the terms of a Guarantee and Collateral Agreement, dated March 3, 2020 and the other security documents.

The new credit facility requires the Company to maintain a Consolidated Adjusted Quick Ratio ("AQR") of (i) Consolidated Quick Assets to (ii) Consolidated Current Liabilities minus the current portion of Deferred Revenue of at least 1.25 to 1.00 as of the last day of any fiscal quarter, and, if the AQR is less than 2.00 to 1.00, a Minimum Consolidated EBITDA of at least \$1.00 for any such fiscal

quarter calculated on a trailing 12 month basis. The Company has also agreed to fiscal year dollar limits on its capital expenditures. If an event of default occurs, the lender would be entitled to take various actions, including the acceleration of amounts due under the credit facility and all actions permitted to be taken by a secured creditor.

As of September 30, 2020 there were no amounts outstanding under the Company's revolving line of credit. The amount available to borrow was \$50,000 and the interest rate was 2.75% as of September 30, 2020.

## 9. Commitments

Supplemental cash flow information related to the Company's operating and finance leases was as follows:

	<b>Nine Months Ended September 30, 2020</b>	
<b>Cash Paid for Amounts Included in the Measurement of Lease Liabilities</b>		
Financing cash flows from finance leases	\$	8,880
Operating cash flows from finance leases	\$	6,088
Operating cash flows from operating leases	\$	438
<b>ROU Assets Obtained in Exchange for New Lease Obligations</b>		
Finance lease liabilities	\$	3,593
Operating lease liabilities	\$	-

As of September 30, 2020, the Company had no additional significant operating or finance leases that had not yet commenced.

### Finance Leases

On March 13, 2020, the Company executed an amendment to its three leases for office space on its headquarters campus. Pursuant to this amendment, the Company paid the lessor, a related party, \$3,993 for future rent due in the first half of 2021, representing an approximately 17% discount on rent due for those periods. The ROU assets and financing lease liabilities were adjusted to reflect the effect of the amendment and associated payments.

In February 2020, the Company entered into a financing lease arrangement for servers and networking equipment used in operations. Total payments under the agreement are \$3,723, including the first annual payment of \$784 and two annual payments of \$1,470, each. In connection with this lease, the Company recorded financing ROU assets and financing lease liabilities of \$3,593.

## 10. Redeemable Preferred Stock

On June 4, 2020, the Company issued and sold 1,777,778 shares of its newly created series of preferred stock, par value of \$0.001 per share, designated as "Series A Convertible Preferred Stock" (the "Preferred Stock") to BuildGroup LLC (the "Buyer") at purchase price of \$45 per share, resulting in total gross proceeds for the Company of approximately \$80,000. A member of the Company's Board of Directors is the Chief Executive Officer of the Buyer. The Buyer also has a second representative on the Board.

The Preferred Stock ranks senior to the Company's common stock with respect to dividends and distributions on liquidation, winding-up and dissolution. Each share of the Preferred Stock has an initial stated value of \$45 per share. Holders of shares of the Preferred Stock are entitled to a dividend equal to 8.00% per annum (the "Regular Dividends"), payable quarterly, beginning on June 30, 2020. The Regular Dividends are payable in cash or in kind, at the Company's option. In the event a Regular Dividend is paid in kind, the stated value of each share of the Preferred Stock will be increased by an amount equal to the accrued Regular Dividend not paid in cash. As of September 30, 2020, the Company paid all dividends on the Preferred Stock in cash. Holders of the Preferred Stock are also entitled to participate in and receive any dividends declared or paid on the common stock on an as-converted basis, and no dividends may be paid to holders of the common stock unless full participating dividends are concurrently paid to the holders of the Preferred Stock.

Each holder of the Preferred Stock has the right, at its option, to convert its shares of the Preferred Stock, in whole or in part, into fully paid and non-assessable shares of the common stock, at any time and from time to time. The number of shares of the common stock into which a share of the Preferred Stock will convert at any time is equal to the quotient obtained by dividing its stated value then in effect plus any accumulated and unpaid Regular Dividends by its conversion price of \$15.00. The conversion price is subject to customary anti-dilution adjustments, including in the event of any stock split, stock dividend, recapitalization or similar events. At closing, before payment of any dividends in kind, the 1,777,778 shares of the Preferred Stock were convertible into 5,333,334 shares of common stock.

The Company may, at its option, redeem the outstanding shares of the Preferred Stock following the fourth anniversary of its issuance. Redemption by the Company is subject to certain liquidity conditions as well conditions connected with the trading price of its common stock. Upon redemption by the Company, the Company will pay the holder of the Preferred Stock 105% of the initial stated value of such share plus any increase in the stated value from the initial stated value plus accumulated and unpaid Regular Dividends. If the Company undergoes a change of control as defined in the purchase agreement, the Company must redeem all of the then-outstanding shares of the Preferred Stock for cash consideration equal to the greater of the amount due for redemption as described above and the amount such holder of shares of the Preferred Stock would have received in respect of the number of shares of the Common Stock that would be issuable upon conversion of such share of the Series A Preferred Stock.

Unless and until approval of the Company's stockholders is obtained as contemplated by the NASDAQ listing rules, no holder of the Preferred Stock may convert shares of the Preferred Stock into shares of common stock if and to the extent that such conversion would result in the holder beneficially owning in excess of 19.9% of the then-outstanding shares of the common stock.

As long as not less than 60% of the shares of the Preferred Stock originally issued remain outstanding, the holders of a majority of the then-outstanding shares of the Preferred Stock, voting together as a single class, have the right at any election of directors to elect two directors if the Board consists of nine or fewer directors or three directors if the Board consists of 10. At any time, such elected director(s) may be removed with or without cause only by the affirmative vote or written consent of a majority of the holders of the Preferred Stock entitled to elect such director.

Holders of the Preferred Stock generally are entitled to vote with the holders of the shares of the common stock on all matters submitted for a vote of holders of shares of the common stock (voting together with the holders of shares of the common stock as one class) on an as-converted basis, subject to a limitation of ownership of 19.9% of common stock. Additionally, certain matters require the approval of the holders of a majority of the outstanding shares of the Preferred Stock, voting as a separate class.

The Buyer is subject to limitations while it holds at least 10% of the Preferred Stock originally purchased. Furthermore, until the earliest of May 30, 2024 and receipt of a notice of redemption, the Buyer cannot sell, transfer or otherwise dispose of the shares of the Preferred Stock or the underlying shares of the common stock, subject to limited exceptions that include exceptions in the case of transfers to certain permitted transferees.

For so long as the Buyer and its affiliates collectively hold at least 60% of the shares of the Preferred Stock originally purchased by it or the common stock issuable upon conversion thereof, the Company will pay the Buyer a fee of \$400 for the first year following closing and \$200 per year thereafter. These management and oversight fees are expensed over the period incurred.

The Company incurred \$807 in issuance costs related to the sale of the Preferred Stock, including \$150 of reimbursement to the Buyer for reasonable fees and out-of-pocket expenses incurred by the Buyer in connection with the transaction. The issuance costs were netted against the proceeds from this transaction.

## 11. Stock-based Compensation

### Restricted Stock Units

During the nine months ended September 30, 2020, the Company granted 1,400,301 restricted stock units, or RSUs, to employees and officers with an aggregate grant date fair value of \$14,734. These RSUs generally vest in equal annual installments over various periods ranging from three to four years from the grant date, subject to continued service to the Company. The Company amortizes the grant date fair value of the stock subject to the RSUs on a straight-line basis over the period of vesting. The weighted-average vesting period for these RSUs is approximately 3.09 years from the date of grant.

The Company granted 787,736 performance RSUs with an aggregate grant date fair value of \$8,051 during the nine months ended September 30, 2020. The aggregate grant date fair value of the performance RSUs assuming target achievement was \$6,223. The number of performance RSUs that will vest will be determined upon the achievement of certain financial targets for 2020, and vesting will then occur in equal annual installments over one- and three-year periods from the grant date. The actual number of shares issued upon vesting could range between 0% and 100% of the number of awards granted. The grant date fair value of the stock subject to the performance RSUs is amortized to expense on an accelerated basis over the period of vesting. The weighted-average vesting period for these performance RSUs is approximately 2.36 years from the date of grant, respectively.

## 12. Stockholders' Deficit

### Common Stock

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

At September 30, 2020, the Company had reserved a total of 11,699,792 of its authorized 50,000,000 shares of common stock for future issuance as follows:

Outstanding stock options	122,178
Restricted stock units	2,686,057
Available for future issuance under stock award plans	3,457,840
Available for future issuance under ESPP	100,383
Issuable upon conversion of Series A Preferred Stock	5,333,334
Total common shares reserved for future issuance	<u>11,699,792</u>

Under its stock repurchase program, the Company purchased 1,106,173 shares of its outstanding common stock, for an aggregate of \$9,667 during the nine months ended September 30, 2020. All of these shares have been canceled and returned to its pool of authorized shares to be used for general purposes.

## 13. Revenue

### Disaggregation of Revenue

The following tables provide information about disaggregation of revenue by service line:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Service line:				
Subscription	\$ 44,989	\$ 50,087	\$ 134,759	\$ 145,649
Platform	5,606	4,109	17,739	14,657
Total software services	\$ 50,595	\$ 54,196	\$ 152,498	\$ 160,306
Professional services	12,988	17,469	39,413	48,237
Total	\$ 63,583	\$ 71,665	\$ 191,911	\$ 208,543

#### Contract Balances

The following table provides information about contract assets and contract liabilities from contracts with customers:

	Balance at Beginning of Period	Balance at End of Period
<b>Nine Months Ended September 30, 2020</b>		
Contract assets	\$ 16,685	\$ 6,792
Contract liabilities:		
Deferred revenue	\$ 38,508	\$ 32,782
<b>Nine Months Ended September 30, 2019</b>		
Contract assets	\$ 12,798	\$ 9,185
Contract liabilities:		
Deferred revenue	\$ 45,863	\$ 41,127

The Company recognizes payments from customers based on contractual billing schedules. Accounts receivable are recorded when the right to consideration becomes unconditional. Contract assets include amounts related to the Company's contractual right to consideration for completed performance objectives not yet invoiced. Contract liabilities include payments received in advance of performance under the contract and are recognized as revenue when earned under the contract. The Company had no asset impairment charges related to contract assets during the nine months ended September 30, 2020 and 2019.

There were no significant changes in the contract assets outside of standard revenue and billing activity.

Revenue recognized during the three and nine months ended September 30, 2020 that was included in the deferred revenue balance at the beginning of the period was \$17,206 and \$32,421, respectively.

The Company recorded favorable adjustments to revenue arising from performance obligations satisfied or partially satisfied in previous periods \$972 and \$2,892 during the three and nine months ended September 30, 2020, respectively.

#### Performance Obligations

As of September 30, 2020, the aggregate amount of the Company's performance obligations that are unsatisfied or partially unsatisfied were approximately \$170,000, of which a majority are expected to be satisfied within the next three years. The Company excludes from its population of performance obligations contracts with original durations of one year or less, contract renewal periods that renew automatically, and amounts of variable consideration that are allocated to wholly unsatisfied distinct service that forms part of a single performance obligation and meets certain variable allocation criteria.

#### 14. Income Taxes

The Company's effective federal tax rate for the nine months ended September 30, 2020 was less than one percent, primarily as a result of estimated tax losses for the fiscal year to date offset by the increase in the valuation allowance in the net operating loss carryforwards. Current tax expense relates to estimated state income taxes.

#### 15. Segments and Geographic Information

The Company views its operations and manages its business as one operating segment. Segment information matches the consolidated financial information for the current period and prior periods reported.

## 16. Related Parties

### **Series A Preferred Stock**

As described in Note 10, the Company sold 1,777,778 shares of Preferred Stock to an entity whose Chief Executive Officer is a member of the Company's Board of Directors. In connection with this transaction, the Company reimbursed the Buyer \$150 for fees incurred in closing the sale of Preferred Stock in June 2020. The Company paid dividends of \$1,600 and \$2,062 to the buyer for the three and nine months ended September 30, 2020, respectively. Additionally, the Company paid management and oversight fees of \$129 to the Buyer for three and nine months ended September 30, 2020. The significant terms of the Preferred Stock are described in Note 10.

### **Leasing Arrangements**

The Company leases its office space at its Charleston, South Carolina headquarters campus under the terms of three non-cancellable leases from entities affiliated with an executive who is also a Company director and significant stockholder. The Company's headquarter campus building leases are accounted for as financing lease ROU assets and lease liabilities on the Consolidated Balance Sheet as of September 30, 2020. The three lease agreements have 15-year terms ending on December 31, 2031, with Company options to renew for five additional years. The arrangements provide for 3.0% fixed annual rent increases. Payments under these agreements were \$2,594 and \$2,519 for the three months ended September 30, 2020 and 2019, respectively and \$12,525 and \$8,348 for the nine months ended September 30, 2020 and 2019, respectively. Other amounts due to these related parties were \$627 and \$791 as of September 30, 2020 and December 31, 2019, respectively, and were recorded in "Accrued expenses". Payments made for the nine months ended September 30, 2020 include amounts paid in connection with the amendment of these leases discussed in Note 9.

### **Other Related Party Expenses**

The Company utilizes the services of various companies that are owned and controlled by an executive who is also a Company director and significant stockholder. The companies provide construction project management services, private air transportation and other services. There were no expenses related to these companies for the three months ended September 30, 2020. Expenses related to these companies were \$82 for the three months ended September 30, 2019 and \$127 and \$237 for the nine months ended September 30, 2020 and 2019, respectively. Amounts due to these companies were \$24 as of September 30, 2020. There were no amounts due to these companies as of December 31, 2019.

The Company purchased software and services from a company affiliated with a Company director. Payments related to this agreement were \$26 and \$24 for the three months ended September 30, 2020 and 2019, respectively and \$77 and \$82 for the nine months ended September 30, 2020 and 2019, respectively. Amounts due to this company were \$26 as of September 30, 2020. There were no amounts due to this company as of December 31, 2019.

## 17. Subsequent Events

### **Restricted Stock Units**

During October 2020, the Company granted 90,215 RSUs with an aggregate grant date fair value of \$1,038. These RSUs generally vest in equal annual installments over various periods ranging from one to four years from the grant date. The weighted-average vesting period for these RSUs is approximately 3.61 from the date of grant.

The Company granted 13,717 performance RSUs with an aggregate grant date fair value of \$158 during October 2020. The aggregate grant date fair value of the performance RSUs assuming target achievement was \$115. The number of performance RSUs that will vest will be determined upon the achievement of certain financial targets for 2020, and vesting will then occur in equal annual installments over a three-month and two-year and seven-month period from the grant date. The actual number of shares issued upon vesting could range between 0% and 100% of the number of awards granted. The grant date fair value of the stock subject to the performance RSUs is amortized to expense on an accelerated basis over the period of vesting. The weighted-average vesting period for these performance RSUs is approximately 2.16 years from the date of grant, respectively.

### **Common Stock**

During October and November 2020, employees exercised stock options and RSUs vested resulting in the issuance of 25,836 shares of the Company's common stock.

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and with the financial statements, related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" included in Item 1A of Part II of this Quarterly Report on Form 10-Q, and the risks discussed in our other SEC filings.*

### Overview

Benefitfocus provides a leading cloud-based benefits management platform for buyers (consumers, employees and employers) and sellers (insurance brokers, carriers and suppliers). The Benefitfocus Platform simplifies how organizations and individuals transact benefits. Our employer, carrier, broker and supplier customers rely on our platform to manage, scale and exchange benefits data seamlessly. Our solutions drive value for all participants in our benefits ecosystem.

The Benefitfocus platform has a multi-tenant architecture and a user-friendly interface designed for consumers to access all of their benefits in one place. Our comprehensive solutions support medical benefit plans and non-medical benefits, such as dental, life, disability insurance, income protection, digital health and financial wellness. Our platform includes artificial intelligence functionality designed to help consumers identify and evaluate benefit options offered by their employer. As the number of employer benefits plans has increased, with each plan subject to many different business rules and requirements, demand for the Benefitfocus Platform is growing.

In 2018, we expanded our economic model to include a transaction-oriented, buyer solution, known as Benefit Catalog (formerly BenefitsPlace), designed to align brokers, carriers and suppliers around the needs of employers, employees and consumers. In this model, our seller partners offer their voluntary and specialty benefit products through a holistic, multidimensional marketplace. This marketplace is designed to increase the economic value of the consumer lives on our platform by aligning the product catalog to consumer needs. In exchange for Benefitfocus delivering consumer access, data-driven analysis and operational efficiencies, seller partners pay us a percentage of the purchases completed on our platform. Carrier agreements have terms of two to four years and are typically cancellable upon breach of contract or insolvency. Supplier contracts have terms of one year or less and are generally cancellable upon breach of contract, failure to cure, bankruptcy and termination for convenience.

We classify our revenue into three streams – subscription, platform, and professional services revenue. Subscription and platform revenue are combined and reported as software services revenue.

Subscription revenue primarily consists of monthly subscription fees paid to us by our employer and insurance carrier customers for access to, and usage of, cloud-based benefits software solutions for a specified contract term. Subscription fees are generally charged based on the number of employees or subscribers with access to the solution. Subscription revenue accounted for approximately 71% and 70% of our total revenue during the three-month period ended September 30, 2020 and 2019, respectively, and approximately 70% during each of the nine-month periods ended September 30, 2020 and 2019.

Platform revenue includes Benefit Catalog transactional revenue, which is generated from the value of the policies or products enrolled in through our marketplace. Benefit Catalog revenue from insured products is generally recognized over the policy period of the enrolled products. In arrangements where we sell policies to employees of our customers as the broker, we earn insurance broker commissions. Revenue from insurance broker commissions and Benefit Catalog supplier transactions is generally recognized at the time when open enrollment is complete and the orders for policies are transferred to the supplier. Platform revenue accounted for approximately 9% and 6% of our total revenue during the three-month period ended September 30, 2020 and 2019, respectively, and approximately 9% and 7% of our total revenue during the nine-month period ended September 30, 2020 and 2019, respectively.

Our professional services revenue stream is largely derived from the implementation of our customers onto our platform, which typically includes discovery, configuration and deployment, integration, testing, and training. We also provide customer support services and customized media content that supports our customers' effort to educate and communicate with consumers. Professional services revenue accounted for approximately 20% and 24% of our total revenue during the three-month period ended September 30, 2020 and 2019, respectively, and approximately 21% and 23% of our total revenue during the nine-month period ended September 30, 2020 and 2019, respectively.

Expanding our customer base is a key element of our growth strategy. We believe that our continued innovation and new solutions, including artificial intelligence-enabled tools and Benefit Catalog, which extend the functionality of our mobile offerings, provide more robust data analytics capabilities, and enhance our ability to quickly respond to evolving market needs with innovative capabilities, will help us attract additional net benefit eligible lives to our platform through new employer customers, partners, and brokers, and increase our revenue from existing customers and relationships.

We believe that there is a substantial market for our services, and we have been investing in growth over the past several years. In particular, we have continued to invest in technology and services to better serve our larger employer customers, which we believe are an important source of growth for our business. We have also substantially increased our marketing and sales efforts. As we have invested in growth, we have had GAAP operating losses in each of the last nine years, and expect our GAAP operating losses to continue for at least the next year.

On March 11, 2020, the World Health Organization classified the COVID-19 outbreak as a pandemic. We continue to actively monitor COVID-19 and its potential impact on our operations and financial results. In response to the pandemic, we implemented cost management actions in the second quarter of 2020 to maintain our financial health and liquidity through these economic uncertain times. These include actions to reduce our workforce by approximately 17%, renegotiating vendor service contracts and reducing discretionary expenditures such as travel and professional services. These actions also include investing in accelerating automation efforts to gain efficiencies.

As a result of shelter-in-place restrictions that were effective during the second quarter of 2020, we experienced delays in completing selling. We believe the financial impacts from COVID-19 are temporary in nature and do not significantly affect our business model and growth strategy. Therefore, we do not consider COVID-19 to have been a triggering event to accelerate our annual impairments tests.

We evaluated our goodwill and indefinite-lived intangible assets and determined there were no interim triggering events as it was not more likely than not that the fair value of our reporting units would be less than their respective carrying amounts. Additionally, we evaluated our long-lived assets, including our property, plant and equipment, lease right-of-use assets and other intangible assets, noting no indicators of impairment.

The impact that COVID-19 will have on our consolidated financial statements throughout 2020 remains uncertain and ultimately will be dictated by the length and severity of the pandemic, which is increasing in many parts of the United States, as well as the economic recovery and federal, state and local government actions taken in response. We will continue to evaluate the nature and extent of these potential impacts to our business and consolidated financial statements.

While the ultimate impact of the pandemic on our business and financial results remains uncertain, we believe our business could be impacted by the following in the near term, among other things:

- **New sales.** We expect to experience longer sales cycles and a slowdown in new sales activity which we expect to negatively impact professional services revenue and platform revenue from new business.
- **Unemployment.** We expect the increase in unemployment caused by the pandemic will negatively impact platform revenue by decreasing the rate at which our Benefits Catalog voluntary benefits offerings are purchased. We expect our subscription revenue will be impacted to a lesser extent depending on the level of contractual minimums in our contracts and a delay in when unemployed workers leave our platform. In addition, we expect unemployment to potentially cause a decrease in net benefit eligible lives on our platform in the near term.
- **Participation in Voluntary Benefits.** We expect a decrease in the participation of lives on our platform in purchasing voluntary benefits as a result of the economic impacts of the pandemic on income levels across the country.

As a result of the nature of our customer relationships, the stability of our subscription revenue, the cost restructuring actions taken in the second quarter of 2020 and our ongoing investments in automation, we believe we will be able to increase cash flows from operations and achieve profitability in the relatively near future. Of course, our ability to achieve profitability will continue to be subject to many risks and factors beyond our control like the COVID-19 pandemic.

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

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

## Adjusted EBITDA

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

Beginning in the third quarter of 2020, we revised our definition of adjusted EBITDA to also exclude the gain or loss on the extinguishment of debt. This revision to the definition had no impact on our reported adjusted EBITDA for periods prior to the change and increased our adjusted EBITDA by \$1.1 million in the three and nine months ended September 30, 2020.

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

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized might have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not reflect the potentially dilutive impact of stock-based compensation;
- adjusted EBITDA does not reflect interest or tax payments that would reduce the cash available to us; and
- other companies, including companies in our industry, might calculate adjusted EBITDA or a similarly titled measure differently, which reduces their usefulness as comparative measures.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
<b>Reconciliation from Net Loss to Adjusted EBITDA:</b>				
Net loss	\$ (4,396)	\$ (12,577)	\$ (27,394)	\$ (41,724)
Depreciation	3,774	3,848	11,496	11,505
Amortization of software development costs	2,032	1,263	5,278	3,760
Amortization of acquired intangible assets	568	569	1,705	1,364
Interest income	(40)	(673)	(563)	(2,095)
Interest expense	5,771	5,926	17,524	17,577
Income tax expense	6	17	17	26
Stock-based compensation expense	3,859	4,415	10,859	14,501
Transaction and acquisition-related costs expensed	18	3	425	1,005
Restructuring costs	-	-	5,616	-
Gain on repurchase of convertible senior notes	(1,138)	-	(1,138)	-
Costs not core to our business	-	63	-	649
Total net adjustments	14,850	15,431	51,219	48,292
Adjusted EBITDA	\$ 10,454	\$ 2,854	\$ 23,825	\$ 6,568

### Net Benefit Eligible Lives

We are focused on driving revenue growth from adding lives to our platform and driving incremental transaction revenue. We believe the number of net benefit eligible lives is a key indicator of our market penetration, growth and future revenue. We believe net benefit eligible lives is highly correlated to our subscription revenue and is the foundation of our transaction revenue opportunity. We define a net benefit eligible life as a person with access to a benefits enrollment subscription under standard contracting or a freelancer with access to benefits enrollment, plus their estimated dependents, as of the measurement date. This definition excludes lives from other subscription-related contracts.

	As of September 30,	
	2020	2019
	(in millions)	
Net benefit eligible lives	18.2	16.8

Freelancers have been primary contributors to recent growth in our net benefit eligible lives. Freelancers generate only platform revenue by purchasing voluntary benefits and other offerings. The participation rate of freelancers on our platform is currently low.

### Software Services Revenue Retention Rate

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

Our software services revenue retention rate was greater than 90% for the three and nine months ended September 30, 2020 compared to being greater than 95% for the three and nine months ended September 30, 2019. The reduction in the rate was primarily result of the impact on 2020 revenue from the renegotiation of a customer contract. Excluding this customer, our software revenue retention rate exceeded 95% for both periods. We expect our software revenue retention rate will continue to be negatively impacted for the remainder of 2020 by the effects of this customer contract negotiation along with the potential impacts of unemployment as a result of COVID-19 pandemic.

### Components of Operating Results

#### Revenue

We derive the majority of our revenue from monthly subscription fees paid to us by our employer and carrier customers for access to, and usage of, our cloud-based benefits software solutions for a specified contract term. We derive platform revenue from both insurance broker commissions from the sale of voluntary and ancillary benefits policies to employees of our customers and from transaction revenue from life and ancillary insurance carriers and specialty providers. We also derive revenue from professional services fees, which primarily include fees related to the implementation of our customers onto our platform. Our professional services typically include discovery, configuration and deployment, integration, testing, and training.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Subscription	\$ 44,989	\$ 50,087	\$ 134,759	\$ 145,649
Platform	5,606	4,109	17,739	14,657
Total software services	\$ 50,595	\$ 54,196	\$ 152,498	\$ 160,306
Professional services	12,988	17,469	39,413	48,237
Total revenue	\$ 63,583	\$ 71,665	\$ 191,911	\$ 208,543

We recognize revenue when control of these services is transferred to customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services. Taxes collected from customers relating to services and remitted to governmental authorities are excluded from revenues.

We determine revenue recognition through the following steps:

- Identification of each contract with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and

- Recognition of revenue when, or as, performance obligations are satisfied.

#### *Software Services Revenue*

Software services revenue consists of subscription and platform revenue.

#### *Subscription Revenue*

Subscription revenue primarily consists of monthly subscription fees paid to us by our customers for access to, and usage of, cloud-based benefits software solutions for a specified contract term. Fees are generally charged based on the number of employees or subscribers with access to the solution.

Subscription revenue is generally recognized on a ratable basis over the contract term beginning on the date the subscription services are made available to the customer. Our subscription service contracts are generally three years.

Subscription revenue also includes fees paid for other services, such as event sponsorships and certain data services.

#### *Platform Revenue*

Platform revenue is generated from the value of the policies or products enrolled in through our marketplace. Platform revenue from carriers is generally recognized over the policy period of the enrolled products. In arrangements where we sell policies to employees of our customers as the broker, we earn insurance broker commissions. Revenue from insurance broker commissions and Benefit Catalog (formerly BenefitsPlace) supplier transactions is recognized at the point when the orders for the policies are received and transferred to the insurance carrier or supplier, and is reduced by constraints for variable consideration associated with collectability, policy cancellation and termination risks.

#### *Professional Services Revenues*

Professional services revenue primarily consists of fees related to the implementation of software products purchased by customers. Professional services typically include discovery, configuration and deployment, integration, testing, and training. Fees from consulting services, support services and training are also included in professional services revenue.

We determined that implementation services for certain of our insurance carrier customers significantly modify or customize the software solution and, as such, do not represent a distinct performance obligation. Accordingly, revenue from such implementation services with these insurance carrier customers are generally recognized over the contract term of the associated software services contract, including any extension periods representing a material right. We utilize estimates of hours as a measure of progress to determine revenue for certain types of arrangements.

Revenue from implementation services with employer customers is generally recognized as those services are performed.

Revenue from support and training fees is recognized over the service contract period.

#### *Contracts with Multiple Performance Obligations*

Certain of our contracts with customers contain multiple performance obligations. For these contracts, the individual performance obligations are accounted for separately if they are distinct. The transaction price is allocated to the separate performance obligations based on their relative standalone selling prices. We determine the standalone selling prices based on their overall pricing objectives, taking into consideration market conditions and other factors, including the value of their contracts, the software services sold, customer size and complexity, and the number and types of users within the contracts.

#### **Overhead Allocation**

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

#### **Cost of Revenue**

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

We expense cost of revenue associated with fulfilling performance obligations as we incur the costs. Costs that relate directly to a customer contract that are not related to satisfying a performance obligation are capitalized and amortized to cost of revenue expense over the estimated period of benefit of the contract asset, which is generally five years.

Subscription and platform revenue are both generated from our platform and result from the same set of assets and activities. As such, we are not able to meaningfully separate and assign costs of revenue to subscription and platform revenue separately.

We expect cost of revenue as a percentage of revenue to decline and gross margins to increase as we realize the full impact of our restructuring activities and increased automation. However, this trend may vary on a quarterly basis.

## **Operating Expenses**

Operating expenses consist of sales and marketing, research and development, and general and administrative expenses. Salaries and personnel-related costs are the most significant component of each of these expense categories. We expect to decrease our operating expenses, as a percentage of revenue, if and as we achieve economies of scale and as a result of restructuring actions taken in April 2020.

*Sales and marketing expense.* Sales and marketing expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, stock-based compensation and commissions, for our sales and marketing associates. Costs to obtain a contract that are incremental, such as sales commissions, are capitalized and amortized to expense over the estimated period of benefit of the asset, which is generally four to five years. Additional expenses include advertising, lead generation, promotional event programs, corporate communications, travel, and allocated overhead. For instance, our most significant promotional event is One Place, which we hold annually. We expect our sales and marketing expense to decrease, in absolute dollars, in the near term as we achieve the savings expected from the restructuring actions taken in April 2020.

*Research and development expense.* Research and development expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses and stock-based compensation, for our research and development associates. Additional expenses include costs related to the development, quality assurance, and testing of new technology, and enhancement of our existing platform technology, consulting, travel, and allocated overhead. We believe continuing to invest in research and development efforts is essential to maintaining our competitive position.

*General and administrative expense.* General and administrative expense consists primarily of salaries and other personnel-related costs, including benefits, bonuses, and stock-based compensation for administrative, finance and accounting, information systems, legal, and human resource associates. Additional expenses include consulting and professional fees, insurance and other corporate expenses, and travel. We expect our general and administrative expenses to decrease in absolute terms as a result of the restructuring actions taken in April 2020, which included reducing headcount, renegotiating vendor service contracts, restricting travel, and reducing discretionary expenditures such as consultants.

*Restructuring costs.* Restructuring costs are comprised of one-time severance charges, continuation of health benefits and outplacement services. As discussed above in "Overview," in the quarter ended June 30, 2020, we reduced our work force by approximately 17%.

## **Other Income and Expense**

Other income and expense consists primarily of interest income and expense, gain on repurchase of senior convertible notes and gain (loss) on disposal of property and equipment. Interest income represents interest received on our cash and cash equivalents. Interest expense consists primarily of the interest incurred on outstanding convertible debt and borrowings under our lease arrangements and credit facility. During the third quarter of 2020, we repurchased outstanding senior convertible notes which resulted in a gain.

## **Income Tax Expense**

Income tax expense consists of U.S. federal and state income taxes. We incurred minimal income tax expense for the three and nine months ended September 30, 2020 and 2019.

On March 27, 2020, the "Coronavirus Aid, Relief and Economic Security (CARES) Act" was signed into law. The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property. Except for utilizing the deferment of employer social security payments, we do not expect the CARES Act to have a material impact on our financial results. We continue to examine the impacts the CARES Act may have on our business.

## Results of Operations

### Consolidated Statements of Operations Data

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue	\$ 63,583	\$ 71,665	\$ 191,911	\$ 208,543
Cost of revenue <sup>(1)</sup>	30,113	35,588	94,422	101,242
Gross profit	33,470	36,077	97,489	107,301
Operating expenses:				
Sales and marketing <sup>(1)</sup>	12,405	18,527	39,863	57,464
Research and development <sup>(1)</sup>	11,439	14,088	34,252	41,639
General and administrative <sup>(1)</sup>	9,424	10,772	29,320	34,353
Restructuring costs <sup>(1)</sup>	-	-	5,616	-
Total operating expenses	33,268	43,387	109,051	133,456
Income (loss) from operations	202	(7,310)	(11,562)	(26,155)
Other income (expense):				
Interest income	40	673	563	2,095
Interest expense	(5,771)	(5,926)	(17,524)	(17,577)
Gain on repurchase of convertible senior notes	1,138	-	1,138	-
Other income (expense)	1	3	8	(61)
Total other expense, net	(4,592)	(5,250)	(15,815)	(15,543)
Loss before income taxes	(4,390)	(12,560)	(27,377)	(41,698)
Income tax expense	6	17	17	26
Net loss	\$ (4,396)	\$ (12,577)	\$ (27,394)	\$ (41,724)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Cost of revenue	\$ 1,304	\$ 798	\$ 2,604	\$ 2,388
Sales and marketing	766	923	2,240	2,597
Research and development	785	690	1,717	2,600
General and administrative	1,004	2,004	4,298	6,916
Restructuring costs	-	-	-	-

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue	47.4	49.7	49.2	48.5
Gross profit	52.6	50.3	50.8	51.5
Operating expenses:				
Sales and marketing	19.5	25.9	20.8	27.6
Research and development	18.0	19.7	17.8	20.0
General and administrative	14.8	15.0	15.3	16.5
Restructuring costs	-	-	2.9	-
Total operating expenses	52.3	60.5	56.8	64.0
Income (loss) from operations	0.3	(10.2)	(6.0)	(12.5)
Other income (expense):				
Interest income	0.1	0.9	0.3	1.0
Interest expense	(9.1)	(8.3)	(9.1)	(8.4)
Gain on repurchase of convertible senior notes	1.8	-	0.6	-
Other income (expense)	-	-	-	-
Total other expense, net	(7.2)	(7.3)	(8.2)	(7.5)
Loss before income taxes	(6.9)	(17.5)	(14.3)	(20.0)
Income tax expense	-	-	-	-
Net loss	(6.9)%	(17.5)%	(14.3)%	(20.0)%

### Comparison of Three Months Ended September 30, 2020 and 2019

#### Revenue

	Three Months Ended September 30,				Period-to-Period Change	
	2020		2019		Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue		
	(in thousands)					
Subscription	\$ 44,989	70.8 %	\$ 50,087	69.9 %	\$ (5,098)	(10.2) %
Platform	5,606	8.8	4,109	5.7	1,497	36.4
Total software services	\$ 50,595	79.6 %	\$ 54,196	75.6 %	\$ (3,601)	(6.6) %
Professional services	12,988	20.4	17,469	24.4	(4,481)	(25.7)
Total revenue	\$ 63,583	100.0 %	\$ 71,665	100.0 %	\$ (8,082)	(11.3) %

Subscription revenue decreased by \$5.1 million primarily due to \$3.7 million from the renegotiation of a customer contract and decreases from customers that terminated products and services. These decreases were partially offset by increases from the addition of new customers, contractual price increases and volume increases.

Platform revenue increased from growth in premiums and new products from Benefit Catalog (formerly BenefitsPlace), primarily from insurance carriers. As discussed above in "Components of Operating Results – Revenue", we recognize platform revenue from carriers over the policy period and we recognize commissions revenue at a point in time.

The decrease in professional services revenue was primarily attributable to a decrease in revenue from customers associated with the Connecture, Inc. acquisition in February 2019. Other decreases were attributable to implementation revenue, lower demand for customer-specific development and customer terminations. These decreases more than offset increases from new and existing customers.

We expect total revenue to continue to be less in 2020 compared to 2019 primarily due to the impact of the renegotiation of a customer contract.

#### Cost of Revenue

	Three Months Ended September 30,				Period-to-Period Change	
	2020		2019		Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue		
	(in thousands)					
Cost of revenue	\$ 30,113	47.4 %	\$ 35,588	49.7 %	\$ (5,475)	(15.4) %

The decrease in cost of revenue was attributable to decreases in salaries and other personnel-related costs of \$3.1 million, costs related to external development and engineering consulting of \$2.6 million, and travel-related expenses of \$0.5 million. These decreases result from our actions taken during the period in response to the COVID-19 pandemic to maintain financial health and liquidity discussed above in "Overview." These decreases were partially offset by increased depreciation expense of \$0.8 million attributable to higher depreciation expense related to an increase in capitalized software development costs. Cost of revenue included \$1.3 million and \$0.8 million of stock-based compensation expense for the three-month periods ended September 30, 2020 and 2019, respectively, and \$4.8 million and \$4.0 million of depreciation and amortization for the three-month periods ended September 30, 2020 and 2019, respectively.

### Gross Profit

	Three Months Ended September 30,							
	2020				2019			
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Period-to-Period Change		
						Amount	Percentage	
Software services	\$ 32,477	64.2 %	\$ 36,928	68.1 %	\$ (4,451)	(12.1) %		
Professional services	993	7.6	(851)	(4.9)	1,844	(216.7)		
Gross profit	\$ 33,470	52.6 %	\$ 36,077	50.3 %	\$ (2,607)	(7.2) %		

The decrease in software services gross profit was driven by a \$3.6 million, or 7%, decrease in software services revenue and an increase in software services cost of revenue of \$0.9 million primarily from increased depreciation and amortization expense attributable to an increase in amortization of capitalized internally developed software. Other increases in salary and personnel-related costs were offset by decreases in costs related to external development and engineering consulting and travel-related costs. Software services cost of revenue included \$0.7 million and \$0.5 million of stock-based compensation expense for the three months ended September 30, 2020 and 2019, respectively, and \$4.0 million and \$3.2 million of depreciation and amortization for the three months ended September 30, 2020 and 2019, respectively.

Professional services gross profit increased as professional services revenue decreased by \$4.5 million and cost of revenue decreased by \$6.3 million. The decrease in professional services cost of revenue is primarily attributable to decreases in salary and personnel-related costs due to headcount reductions that took place during the period and decreased utilization of contract labor and external professionals. Professional services cost of revenue included \$0.6 million and \$0.3 million of stock-based compensation expense for the three months ended September 30, 2020 and 2019, respectively. In addition, professional services cost of revenue included \$0.8 million and \$0.9 million of depreciation and amortization for the three months ended September 30, 2020 and 2019, respectively.

We expect the trend of positive professional services margin to continue on an annual basis as a result of investing in accelerating automation and shifting to higher margin professional services work.

### Operating Expenses

	Three Months Ended September 30,							
	2020				2019			
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Period-to-Period Change		
						Amount	Percentage	
Sales and marketing	\$ 12,405	19.5 %	\$ 18,527	25.9 %	\$ (6,122)	(33.0) %		
Research and development	11,439	18.0	14,088	19.7	(2,649)	(18.8)		
General and administrative	9,424	14.8	10,772	15.0	(1,348)	(12.5)		

The decrease in sales and marketing expense was primarily attributable to a \$4.6 million decrease in salaries and personnel-related costs, a \$0.9 million decrease in travel-related costs, and a \$0.2 million decrease in the cost of marketing events. These decreases result from our actions taken during the second quarter of 2020 in response to the COVID-19 pandemic to maintain financial health and liquidity as discussed above in "Overview". The decrease in salaries and personnel-related costs was primarily driven by decreased headcount as well as lower commissions and bonuses earned caused by delays and longer sales cycle time for new sales activity as a result of the COVID-19 pandemic. The decrease in travel-related costs was driven by travel restrictions imposed in response to the pandemic. The cost of marketing events decreased in part as a result of moving our insurance carrier conference, Health Plan Place, to a digital platform in response to the COVID-19 pandemic which resulted in lower costs in the current period compared to the prior period.

The decrease in research and development expense is primarily attributable to a decrease in personnel-related costs and external development and engineering consulting of \$2.5 million. Additionally, a decrease of \$0.1 million in travel-related costs is attributable to travel restrictions imposed in response to the COVID-19 pandemic.

The decrease in general and administrative expense was primarily attributable to a \$1.4 million decrease in salaries and personnel-related costs and contract labor as well as a decrease of \$0.3 million in travel-related costs partially offset by an increase of \$0.3 million professional fees and other operating expenses. These decreases result from our actions taken during the second quarter of 2020 in response to the COVID-19 pandemic to maintain financial health and liquidity as discussed above in "Overview".

## Comparison of Nine Months Ended September 30, 2020 and 2019

### Revenue

	Nine Months Ended September 30,						Period-to-Period Change	
	2020		2019		Amount	Percentage	Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue				
	(in thousands)							
Subscription	\$ 134,759	70.2 %	\$ 145,649	69.8 %	\$ (10,890)	(7.5) %		
Platform	17,739	9.2	14,657	7.0	3,082	21.0		
Total software services	\$ 152,498	79.5 %	\$ 160,306	76.9 %	\$ (7,808)	(4.9) %		
Professional services	39,413	20.5	48,237	23.1	(8,824)	(18.3)		
Total revenue	\$ 191,911	100.0 %	\$ 208,543	100.0 %	\$ (16,632)	(8.0) %		

Subscription revenue decreased primarily due to a \$10.6 million negative impact from the renegotiation of a customer contract, partially offset by \$9.6 million of net increases from the addition of new customers, contractual price increases and volume increases offset by decreases from customers that terminated products and services. The remaining increase is primarily attributable to the acquisition of Connecture, Inc. on February 23, 2019, because the 2020 period includes a full first quarter of revenue related to Connecture products compared to a partial first quarter in the comparable period in 2019.

Platform revenue increased from growth in premiums and new products from Benefit Catalog (formerly BenefitsPlace), primarily from insurance carriers. As discussed above in "Components of Operating Results – Revenue", we recognize platform revenue from carriers over the policy period and we recognize commissions revenue at a point in time.

The decrease in professional services revenue was primarily attributable to a decrease in implementation revenue, customer-specific development, and the result of terminations. The decreases were partially offset by increases from new and existing customers.

We expect total revenue to continue to be less in 2020 compared to 2019 primarily due to the impact of the renegotiation of a customer contract.

### Cost of Revenue

	Nine Months Ended September 30,						Period-to-Period Change	
	2020		2019		Amount	Percentage	Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue				
	(in thousands)							
Cost of revenue	\$ 94,422	49.2 %	\$ 101,242	48.5 %	\$ (6,820)	(6.7) %		

The decrease in cost of revenue in absolute terms was attributable to decreases in salaries and other personnel-related costs and travel-related expense of \$8.0 million as a result of our actions taken during the second quarter of 2020 in response to the COVID-19 pandemic to maintain financial health and liquidity as discussed in above in "Overview". These decreases were partially offset by increased depreciation expense of \$1.8 million attributable to higher depreciation and amortization expense related to an increase in capitalized software development costs and amortization of acquired intangibles related to an acquisition completed in February 2019. The remaining decrease is attributable to decreases in other operating expenses. Cost of revenue increased as a percentage of revenue primarily due to revenue decreasing. Cost of revenue included \$2.6 million and \$2.4 million of stock-based compensation expense for the nine-month periods ended September 30, 2020 and 2019, respectively, and \$13.7 million and \$11.9 million of depreciation and amortization for the nine-month periods ended September 30, 2020 and 2019, respectively.

### Gross Profit

	Nine Months Ended September 30,						Period-to-Period Change	
	2020		2019		Amount	Percentage	Amount	Percentage
	Amount	Percentage of Revenue	Amount	Percentage of Revenue				
	(in thousands)							
Software services	\$ 96,413	63.2 %	\$ 110,378	68.9 %	\$ (13,965)	(12.7) %		
Professional services	1,076	2.7	(3,077)	(6.4)	4,153	(135.0)		
Gross profit	\$ 97,489	50.8 %	\$ 107,301	51.5 %	\$ (9,812)	(9.1) %		

The decrease in software services gross profit was driven by a \$7.8 million, or 5%, decrease in software services revenue and an increase in software services cost of revenue of \$6.2 million from increases in salary and personnel-related costs and depreciation expense. The increase in software services costs of revenue was primarily attributable to increased investment to support our ongoing customers and primarily driven by increases in salary and personnel-related costs and external development and engineering consulting of \$5.0 million and depreciation and amortization expense of \$1.5 million related to capitalized software development costs. The increase in software services cost of revenue included \$1.5 million and \$1.3 million of stock-based compensation expense for the nine months ended September 30, 2020 and 2019, respectively, and \$11.3 million and \$9.5 million of depreciation and amortization for the nine months ended September 30, 2020 and 2019, respectively.

Professional services gross profit increased \$4.2 million as professional services revenue decreased by \$8.8 million and cost of revenue decreased by \$13.0 million. The decrease in professional services cost of revenue is primarily attributable to decreases in salary and personnel-related costs due to headcount reductions that took place during the period and decreased utilization of contract labor. Additionally, salaries and personnel-related costs were impacted by an increase in the deferral of fulfillment costs from carrier implementation projects and a decrease in amortization of capitalized fulfillment costs as older projects became fully amortized. Professional services cost of revenue included \$1.1 million of stock-based compensation expense for each of the nine months ended September 30, 2020 and 2019. In addition, professional services cost of revenue included \$2.5 million and \$2.4 million of depreciation and amortization for the nine months ended September 30, 2020 and 2019, respectively.

We expect the trend of positive professional services margin to continue on an annual basis as a result of investing in accelerating automation and shifting to higher margin professional services work.

### Operating Expenses

	Nine Months Ended September 30,							
	2020				2019			
	Amount	Percentage of Revenue	(in thousands)	Amount	Percentage of Revenue	Period-to-Period Change		
						Amount	Percentage	
Sales and marketing	\$ 39,863	20.8 %	\$ 57,464	27.6 %	\$ (17,601)	(30.6) %		
Research and development	34,252	17.8	41,639	20.0	(7,387)	(17.7)		
General and administrative	29,320	15.3	34,353	16.5	(5,033)	(14.7)		
Restructuring costs	5,616	2.9	-	0.0	5,616	100.0		

The decrease in sales and marketing expense was primarily attributable to a \$12.8 million decrease in salaries and personnel-related costs, a \$2.5 million decrease in travel-related costs, and a \$2.0 million decrease in the cost of marketing events. These decreases result from our actions taken during the second quarter of 2020 in response to the COVID-19 pandemic to maintain financial health and liquidity as discussed above in "Overview". The decrease in salaries and personnel-related costs was driven by decreased headcount as well as lower commissions and bonuses earned caused by delays and longer sales cycle time for new sales activity as a result of the COVID-19 pandemic. The decrease in travel-related costs was driven by travel restrictions imposed in response to the pandemic. The cost of marketing events decreased in part as a result of moving our events, including our user conference, OnePlace, to a digital platform in response to the COVID-19 pandemic which resulted in lower costs in the current period compared to the prior period.

The decrease in research and development expense is primarily attributable to a decrease personnel-related costs and external development and engineering consulting of \$6.8 million. Additionally, a decrease of \$0.3 million in travel-related costs is attributable to travel restrictions imposed in response to the COVID-19 pandemic.

The decrease in general and administrative expense was primarily attributable to a \$2.9 million decrease in salaries and personnel-related costs as well as a decrease of \$2.2 million in professional fees, travel-related costs and contract labor. These decreases result from our actions taken during the second quarter of 2020 in response to the COVID-19 pandemic to maintain financial health and liquidity discussed as above in "Overview".

As discussed above in "Overview", in the quarter ended June 30, 2020, we reduced our work force by approximately 17%. Restructuring costs recognized as a result of this action was \$5.6 million and consisted of \$5.3 of salaries and personnel-related expense related to severance payments. The remaining amount is attributable to professional fees for outplacement services and legal fees.

### Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses. In accordance with GAAP, we base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results might differ from these estimates under different assumptions or conditions and, to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. During the nine months ended September 30, 2020 there were no material changes to our critical accounting policies and use of estimates, which are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019, except for current expected credit loss accounting, which changed in connection with the adoption of ASC 326 on January 1, 2020 and is described elsewhere in this Quarterly Report on Form 10-Q.

## Liquidity and Capital Resources

### Sources of Liquidity

As of September 30, 2020, our primary sources of liquidity were our cash and cash equivalents and marketable securities totaling \$176.0 million, \$29.9 million in accounts receivables, net of allowances, and the \$50.0 million unused portion of our revolving line of credit.

We entered into a new revolving line of credit agreement with Silicon Valley Bank on March 3, 2020. This agreement replaces our previous agreement with Silicon Valley Bank, which expired on February 20, 2020. The new three-year agreement has a borrowing limit of \$50 million, with the ability for us to increase it up to \$100 million. We are bound by customary representations and warranties and restrictive covenants in connection with the revolving line of credit, including financial covenants related to quick ratio and EBITDA. In the event of a default, the lenders may declare all obligations immediately due and stop advancing money or extending credit under the line of credit. The line of credit is collateralized by substantially all of our personal property assets, including intellectual property and the equity of our subsidiaries. The terms of our revolving line of credit are described in Note 8 of the unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

In June 2020, we issued 1,777,778 shares of Series A Preferred Stock (the "Preferred Stock") at a purchase price of \$45 per share, resulting in total gross proceeds of approximately \$80 million. The Preferred Stock ranks senior to our common stock with respect to dividends and distributions on liquidation, winding-up and dissolution. Each share of the Preferred Stock has an initial stated value of \$45 per share. Holders of shares of the Preferred Stock are entitled a dividend equal to 8.00% per annum (the "Regular Dividends"), payable quarterly, beginning on June 30, 2020. The Regular Dividends are payable in cash or in kind, at our option. In the event a Regular Dividend is paid in kind, the stated value of each share of the Preferred Stock will be increased by an amount equal to the accrued Regular Dividend not paid in cash. As of September 30, 2020, we had paid all of the Preferred Stock dividends in cash. Holders of the Preferred Stock are also entitled to participate in and receive any dividends declared or paid on the common stock on an as-converted basis, and no dividends may be paid to holders of the common stock unless full participating dividends are concurrently paid to the holders of the Preferred Stock. Each holder of the Preferred Stock has the right, at its option, to convert its shares of the Preferred Stock, in whole or in part, into fully paid and non-assessable shares of the common stock, at any time and from time to time. The number of shares of the common stock into which a share of the Preferred Stock will convert at any time is equal to the quotient obtained by dividing its stated value then in effect plus any accumulated and unpaid Regular Dividends by its conversion price of \$15.00. The conversion price is subject to customary anti-dilution adjustments, including in the event of any stock split, stock dividend, recapitalization or similar events. At closing, before payment of any dividends in kind, the 1,777,778 shares of the Preferred Stock were convertible into 5,333,334 shares of common stock. We may, at our option, redeem the outstanding shares of the Preferred Stock following the fourth anniversary of issuance. Redemption by us is subject to certain liquidity conditions, as well conditions connected with the trading price of its common stock. The terms of the Preferred Stock are described in Note 10 of our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

In December 2018, we issued \$240 million aggregate principal amount of 1.25% convertible senior notes (the "Notes") due December 15, 2023, unless earlier purchased by us or converted by the holder pursuant to their terms. Interest is payable semiannually in arrears on June 15 and December 15 of each year. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination, at our election. The Notes have an initial conversion rate of 18.8076 shares of common stock per \$1,000 principal amount. This represents an initial effective conversion price of approximately \$53.17 per share of common stock.

In connection with the issuance of the Notes, we entered into capped call transactions with certain counterparties affiliated with the initial purchasers and others. The capped call transactions are expected to reduce potential dilution of earnings per share upon conversion of the Notes. Under the capped call transactions, we purchased capped call options that in the aggregate relate to the total number of shares of our common stock underlying the Notes, with an initial strike price of approximately \$53.17 per share, which corresponds to the initial conversion price of the Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the Notes, and have a cap price of approximately \$89.98. The terms of the Notes are described further in Note 7 of our unaudited consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

During the third quarter of 2020, we repurchased Notes with an aggregate principal amount of \$18.8 million for an aggregate of \$14.6 million in cash. As of the end of the third quarter of 2020, the remaining outstanding Notes were convertible into 4,161,182 shares of common stock. In connection with the purchase of the Notes, we terminated a portion of the capped call transactions which resulted in an immaterial amount of payments to us in cash and shares of our common stock.

Our cash flows from operations has improved in recent years and was positive for the year ended December 31, 2018. However, cash flows from operations may fluctuate between positive and negative due to the timing of payments and collections of cash on both a quarterly and annual basis.

On April 28, 2020, we announced a restructuring plan to tightly manage costs and further strengthen our liquidity profile in response to the impact of the COVID-19 pandemic. This restructuring plan resulted in a reduction in our U.S. workforce of approximately 17% that was implemented in the second quarter of 2020. We incurred restructuring costs of \$5.6 million in the second quarter of 2020 from one-time severance charges, continuation of health benefits and outplacement services.

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

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

### **Commitments**

On March 13, 2020, we executed an amendment to our three leases for office space on our headquarters campus. Pursuant to this amendment, we paid the lessor, a related party, approximately \$4.0 million for future rent due in the first half of 2021, representing an approximately 17% discount on rent due for those periods. The respective right-of-use assets and financing lease liabilities were adjusted to reflect the effect of the payment.

In February 2020, we entered into a financing lease arrangement for servers and networking equipment used in operations. Total payments under the agreement are \$3.7 million, including the first annual payment of \$0.8 million and two annual payments of approximately \$1.5 million. In connection with this lease, we recorded financing ROU assets and financing lease liabilities of \$3.6 million.

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

As of September 30, 2020, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K of the Securities Act, such as the use of unconsolidated subsidiaries, structured finance, special purpose entities or variable interest entities.

### **Recent Accounting Pronouncements**

In August 2020, the FASB issued ASU 2020-06, "Debt - Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40)". The update simplifies the accounting for convertible debt instruments and convertible preferred stock by reducing the number of accounting models and the number of embedded conversion features that could be recognized separately from the primary contract. This ASU also enhances transparency and improves disclosures for convertible instruments and earnings per share guidance. It is effective for interim and annual reporting periods beginning January 1, 2022. Early adoption is permitted, but no earlier than January 1, 2021. This update permits the use of either the modified retrospective or fully retrospective method of transition. We are currently evaluating the timing and impact of the adoption of ASU 2020-06 on our consolidated financial statements, but we anticipate that it will result in a reduction in non-cash interest expense related to the Notes.

In December 2019, the FASB issued ASU No. 2019-12 "Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes". This ASU is intended to simplify various aspects related to accounting for income taxes, eliminates certain exceptions to the general principles in ASC Topic 740 related to intra-period tax allocation, simplifies when companies recognize deferred taxes in an interim period, and clarifies certain aspects of the current guidance to promote consistent application. This ASU is effective for interim and annual reporting periods starting January 1, 2021. Early adoption is permitted. We are currently evaluating the potential effects of this guidance on our consolidated financial statements.

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

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

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

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

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

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

We are subject to interest rate risk in connection with borrowings under the revolving line of credit, which are subject to a variable interest rate. At September 30, 2020, we had no amounts outstanding under the revolving line of credit.

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

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

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

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

Based on their evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that as of September 30, 2020 our disclosure controls and procedures were designed to, and were effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures as of September 30, 2020.

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

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

## PART II. OTHER INFORMATION.

### Item 1A. RISK FACTORS.

There have been no material changes to the risk factors associated with our business previously disclosed in “Item 1A. Risk Factors,” in our Annual Report on Form 10-K for the period ended December 31, 2019, except as set forth in our Quarterly Reports on Form 10-Q for the periods ended March 31, 2020 and June 30, 2020.

### Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

#### *Purchases of Equity Securities by the Company*

Set forth below is a summary of the shares repurchased by the Company during the three months ended September 30, 2020:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	(d) Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plan or Program
Stock Repurchase Program(1)				\$ 10,333
Other Purchases(2)				
July 1 - 31, 2020	–	\$ –	–	\$ –
August 1 - 31, 2020	–	–	–	–
September 1 - 30, 2020	3,651	–	–	–
Total	3,651	\$ –	–	\$ –

- (1) During the three months ended September 30, 2020, there were no purchases of shares of common stock under the Company’s stock repurchase program, which was announced March 3, 2020, for the potential repurchase of up to \$20 million of the Company’s outstanding common stock.
- (2) In connection with our purchases of Notes in the market, we terminated a corresponding portion of the capped call transactions we had entered into related to the initial issuance of the Notes. As a result of this termination, we received total consideration of \$63, consisting of 3,651 shares of Company common stock and \$26 in cash.

Item 6. EXHIBITS.

Exhibit Number	Exhibit Title	Incorporated by Reference (Unless Otherwise Indicated)			
		Form	File	Exhibit	Filing Date
10.34	<a href="#">First Amendment to Employment Agreement, dated August 25, 2020, by and between Benefitfocus.com and Stephen M. Swad#</a>	8-K	001-36061	10.1	August 26, 2020
10.35	<a href="#">Employment Agreement, dated August 25, 2020, by and between Benefitfocus.com and Alpana Wegner.#</a>	8-K	001-36061	10.2	August 26, 2020
10.36	<a href="#">Separation and Release Agreement, dated August 24, 2020, by and between Benefitfocus.com and Raymond A. August.#</a>	8-K	001-36061	10.3	August 26, 2020
10.37	<a href="#">Separation and Release Agreement dated September 29, 2020, by and between Benefitfocus.com and James P. Restivo.#</a>	8-K	001-36061	10.1	September 30, 2020
31.1	<a href="#">Certification of the President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>	—	—	—	Filed herewith
31.2	<a href="#">Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</a>	—	—	—	Filed herewith
32.1	<a href="#">Certification of the President and Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>	—	—	—	Filed herewith
101.INS	Inline XBRL Instance Document – the Instance Document does not appear in the interactive data file because its XBRL tags are embedded within the Inline XBRL Document.	—	—	—	Filed herewith
101.SCH	Inline XBRL Taxonomy Extension Schema Document.	—	—	—	Filed herewith
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.	—	—	—	Filed herewith
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.	—	—	—	Filed herewith
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document.	—	—	—	Filed herewith
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.	—	—	—	Filed herewith
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).	—	—	—	Filed herewith

# Management contract or compensatory plan.

**SIGNATURES**

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

Date: November 9, 2020

Benefitfocus, Inc.

By: /s/ Alpana Wegner  
Alpana Wegner  
Chief Financial Officer  
(Principal financial and accounting officer)

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

I, Stephen M. Swad, certify that:

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

Date: November 9, 2020

/s/ Stephen M. Swad  
Stephen M. Swad  
*President and Chief Executive Officer*  
(Principal executive officer)

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

I, Alpana Wegner, certify that:

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

Date: November 9, 2020

/s/ Alpana Wegner  
Alpana Wegner  
Chief Financial Officer  
(Principal financial and accounting officer)

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

In accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Stephen M. Swad, President and Chief Executive Officer (principal executive officer) of Benefitfocus, Inc. (the "registrant"), and Alpana Wegner, Chief Financial Officer (principal financial and accounting officer) of the registrant, each hereby certifies that, to the best of their knowledge:

1. The registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2020, to which this Certification is attached as Exhibit 32.1 (the "Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition of the registrant at the end of the period covered by the Report and results of operations of the registrant for the periods covered by the Report.

Date: November 9, 2020

/s/ Stephen M. Swad

Stephen M. Swad  
*President and Chief Executive Officer*  
(Principal executive officer)

/s/ Alpana Wegner

Alpana Wegner  
*Chief Financial Officer*  
(Principal financial and accounting officer)