

TRINET GROUP INC
Form 10-Q
April 29, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

or

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

For the transition period from _____ to _____

Commission File Number: 001-36373

TRINET GROUP, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware 95-3359658
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
One Park Place, Suite 600, Dublin, CA 94568
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (510) 352-5000

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

Indicate by check mark whether the registrant has submitted electronically 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. Yes No

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

The number of shares of Registrant's Common Stock outstanding as of April 22, 2019 was 69,991,585.

TRINET GROUP, INC.
 Form 10-Q - Quarterly Report
 For the Quarterly Period Ended March 31, 2019

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GLOSSARY

Glossary of Acronyms and Abbreviations

Acronyms and abbreviations are used throughout this report, particularly in Part I, Item 1. Unaudited Condensed Consolidated Financial Statements and Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

| | |
|--------|---|
| AFS | Available-for-sale |
| ASC | Accounting standards codification |
| ASU | Accounting standards update |
| CEO | Chief Executive Officer |
| CFO | Chief Financial Officer |
| COPS | Cost of providing services |
| D&A | Depreciation and Amortization |
| EBITDA | Earnings before interest expense, taxes, depreciation and amortization of intangible assets |
| EPS | Earnings Per Share |
| ERISA | Employee Retirement Income Security Act of 1974 |
| FASB | Financial Accounting Standards Board |
| G&A | General and administrative |
| GAAP | Generally Accepted Accounting Principles in the United States |
| HR | Human Resources |
| IRS | Internal Revenue Service |
| ISR | Insurance service revenues |
| MD&A | Management's Discussion and Analysis of Financial Condition and Results of Operations |
| NISR | Net Insurance Service Revenues |
| NSR | Net service revenues |
| OE | Operating expenses |
| PFC | Payroll funds collected |
| PSR | Professional service revenues |
| ROU | Right-of-use |
| RSA | Restricted Stock Award |
| RSU | Restricted Stock Unit |
| SBC | Stock Based Compensation |
| S&M | Sales and marketing |
| SD&P | Systems development and programming |
| SEC | Securities and Exchange Commission |
| SMB | Small to midsize business |
| U.S. | United States |
| WSE | Worksite employee |

FORWARD LOOKING STATEMENTS AND OTHER FINANCIAL INFORMATION

Cautionary Note Regarding Forward-Looking Statements and Other Financial Information

For purposes of this Quarterly Report on Form 10-Q (Form 10-Q), the terms “TriNet,” “the Company,” “we,” “us” and “our” refer to TriNet Group, Inc., and its consolidated subsidiaries. This Form 10-Q contains statements that are not historical in nature, are predictive in nature, or that depend upon or refer to future events or conditions or otherwise contain forward-looking statements within the meaning of Section 21 of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are often identified by the use of words such as, but not limited to, “ability,” “anticipate,” “believe,” “can,” “continue,” “could,” “design,” “estimate,” “expect,” “forecast,” “hope,” “impact,” “intend,” “may,” “outlook,” “plan,” “potential,” “predict,” “project,” “seek,” “should,” “value,” “will,” “would” and similar expressions or variations intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance, but are based on management’s expectations as of the date of this Form 10-Q and assumptions that are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from our current expectations and any past results, performance or achievements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements are discussed throughout our Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC on February 14, 2019 (2018 Form 10-K), including those appearing under the heading “Risk Factors” in Item 1A, and under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 of our 2018 Form 10-K, as well as in our other periodic filings with the SEC. Examples of forward-looking statements include, among others: risks associated with changes in, uncertainty regarding, or adverse application of the complex laws and regulations that govern our business; our ability to be recognized as an employer of worksite employees under federal and state regulations; our ability to mitigate business risks associated with our co-employment relationship with our worksite employees; our ability to secure private and confidential client and worksite employee data and our information technology infrastructure against cyber-attacks and security breaches; our ability to manage unexpected changes in workers’ compensation and health insurance claims by worksite employees; fluctuation in our results of operation and stock price as a result of numerous factors, many of which are outside of our control, such as the volume and severity of our workers’ compensation and health insurance claims and the amount and timing of our insurance costs, operating expenses and capital expenditure requirements; failures or limitations in the business systems we rely upon; our ability to improve our technology to meet the expectations of our clients; our ability to properly manage our internal controls over financial reporting; our ability to effectively integrate businesses we have acquired and new businesses we may acquire in the future; the effects of volatility in the financial and economic environment on the businesses that make up our client base; our ability to effectively manage and improve our operational processes; market acceptance of our vertical strategy; our ability to manage our sales force effectively; the ability of our products and services to compete effectively in our industry; the concentration of our clients in certain geographies and industries; the outcome of existing and future legal proceedings; changes in our income tax positions or adverse outcomes from on-going and future audits; adverse changes in our insurance coverage or our relationships with key insurance carriers; our ability to manage our client attrition; our ability to comply with the restrictions of our credit facility and meet our debt obligations; the impact of concentrated ownership in our stock; and the effects of increased competition and our ability to compete effectively. These and other factors could cause our actual results to differ materially from our anticipated results. The information provided in this Form 10-Q is based upon the facts and circumstances known as of the date of this Form 10-Q, and any forward-looking statements made by us in this Form 10-Q speak only as of the date of this Form 10-Q. We undertake no obligation to revise or update any of the information provided in this Form 10-Q, except as required by law.

The MD&A of this Form 10-Q includes references to our performance measures presented in conformity with GAAP and other non-GAAP financial measures that we use to manage our business, to make planning decisions, to allocate resources and to use as performance measures in our executive compensation plans. Refer to the Non-GAAP Financial Measures in our Key Financial and Operating Metrics section within our MD&A for definitions and reconciliations

from GAAP measures.

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MANAGEMENT'S DISCUSSION
AND ANALYSIS

Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Summary

Overview

TriNet is a leading provider of HR expertise, payroll services, employee benefits and employment risk mitigation services for SMBs. We deliver a comprehensive suite of products and services, which allows our clients to administer and manage various HR-related functions, including compensation and benefits, payroll processing, employee data, health insurance and workers' compensation programs, and other transactional HR needs using our technology platform and HR, benefits and compliance expertise.

We also leverage our scale and industry specific HR experience to design product and service offerings for SMBs in specific industries. We believe our industry-specific approach, which we call our vertical approach, is a key differentiator for us and creates additional value for our clients by allowing our product and service offerings to address the common HR needs in different client industries.

Operational Highlights

Our consolidated results for the first quarter of 2019 reflect our continued progress in attracting new customers to our industry-oriented (vertical) products, serving our existing customers and marketing our brand. The first quarter of the year is our most active for adding new customers.

Our customers are our focus, and we are investing in our processes to ensure a stronger customer experience. We expect this investment will further enhance our value to our customers, support retention and provide further efficiency and scale for our operations. We started this work in 2018 and expect this to continue in the near-term. During the first quarter of 2019, we experienced elevated attrition that was partially offset by improvements where:

- we benefited from our clients growing their WSEs,
- our customers increased their participation, or enrollment in our insurance services offerings, and
- we delivered profitable growth.

Our efforts to build a successful and enduring company include building and leveraging a strong national brand presence. Our branding strategy, Incredible Starts Here, is being augmented with our current campaign: People Matter. We place our customers at the center of what we do, including placing our customers at the center of our marketing.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Performance Highlights

Q1 2019

Our results for the first quarter of 2019 is as follows (percentages, increases or reductions represent changes when compared to the first quarter of 2018):

| | | |
|----------------|------------------|-----------------------|
| \$934M | \$82M | \$251M |
| Total revenues | Operating income | Net Service Revenue * |
| 9 % increase | 17 % increase | 14 % increase |

| | | |
|---------------|---------------|-----------------------|
| \$63M | \$0.89 | \$69M |
| Net income | Diluted EPS | Adjusted Net income * |
| 17 % increase | 19 % increase | 20 % increase |

Non-GAAP

measure as defined

*in the section
below.

| | | |
|-------------------|---------------|----------------------------------|
| 316,906 | 312,760 | \$11.6B |
| Total WSE | Average WSE | Payroll and payroll tax payments |
| % flat | (1)% decrease | 13 % increase |

In Q1 2019, we continued to achieve year-over-year revenue growth which now extends to 24 quarters of growth in total revenues. The growth year-over-year reflects our pricing approach, combined with our changing mix of WSEs and increasing enrollment, by customers that choose to benefit from all of our service offerings. We continue to price to the value of our services and, for our insurance offerings, to our expected risk.

Average WSEs (defined as average monthly WSEs paid during the period) for the first quarter of 2019 decreased 1% compared to the same period in 2018 from higher than normal client attrition in the Main Street vertical related to the platform migration, partially offset by the benefit from new sales combined with increased WSE hiring by our clients. Our change in mix of WSEs over the last year contributed to our growth of both PSR and ISR. The expansion of our NISR margin benefited from the reduced insurance costs in the current quarter.

We continue to enhance our investment strategy to invest available liquid funds to improve our net income and to fund our corporate initiatives.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Key Financial and Operating Metrics

The following key financial and operating metrics should be read in conjunction with our condensed consolidated financial statements and related notes included in this Form 10-Q.

| (in millions, except per share and WSE data) | Three Months Ended March 31, | | |
|--|---------------------------------|--------|-------------|
| | 2019 | 2018 | % Change |
| Income Statement Data: | | | |
| Total revenues | \$934 | \$ 861 | 9 % |
| Operating income | 82 | 71 | 17 |
| Net income | 63 | 54 | 17 |
| Diluted net income per share of common stock | 0.89 | 0.75 | 19 |
| Non-GAAP measures ⁽¹⁾: | | | |
| Net Service Revenues | 251 | 220 | 14 |
| Net Insurance Service Revenues | 115 | 91 | 26 |
| Adjusted EBITDA | 108 | 91 | 18 |
| Adjusted Net Income | 69 | 58 | 20 |

Operating Metrics:

| | | |
|--------------------------|---------|-------------|
| Average WSEs | 312,760 | 14,561 (1) |
| Total WSEs at period end | 316,906 | 16,715 — |

(1) Refer to Non-GAAP Financial Measures section below for definitions and reconciliations from GAAP measures.

| (in millions) | March 31, 2019 | December 31, 2018 | % Change |
|----------------------------|-------------------|----------------------|-------------|
| Balance Sheet Data: | | | |
| Cash and cash equivalents | \$ 251 | \$ 228 | 10 % |
| Working capital | 226 | 221 | 2 |
| Total assets | 2,345 | 2,435 | (4) |
| Long-term debt | 407 | 413 | (1) |
| Total liabilities | 1,939 | 2,060 | (6) |
| Total stockholders' equity | 406 | 375 | 8 |

| (in millions) | Three Months Ended March 31, | | |
|---|---------------------------------|---------|-------------|
| | 2019 | 2018 | % Change |
| Cash Flow Data: | | | |
| Net cash used in operating activities | \$(142) | \$(536) | (73)% |
| Net cash (used in) provided by investing activities | (11) | 2 | (661) |
| Net cash used in financing activities | (47) | (19) | 145 |
| Non-GAAP measure⁽¹⁾: | | | |
| Corporate operating cash flows | 78 | 45 | 16973 |

(1) Refer to Non-GAAP Financial Measures section below for definitions and reconciliations from GAAP measures.

Non-GAAP Financial Measures

In addition to financial measures presented in accordance with GAAP, we monitor other non-GAAP financial measures that we use to manage our business, to make planning decisions, to allocate resources, and to use as performance measures in our executive compensation plan. These key financial measures provide an additional view

of our operational performance over the long-term and provide information that we use in order to maintain and grow our business.

The presentation of these non-GAAP financial measures is used to enhance the understanding of certain aspects of our financial performance. They are not meant to be considered in isolation from, superior to, or as a substitute, for the directly comparable financial measures prepared in accordance with GAAP.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

| Non-GAAP Measure | Definition | How We Use The Measure |
|--------------------------------|--|---|
| Net Service Revenues | <ul style="list-style-type: none"> Sum of professional service revenues and Net Insurance Service Revenues, or total revenues less insurance costs. | <ul style="list-style-type: none"> Provides a comparable basis of revenues on a net basis. Professional service revenues are presented net of client payroll costs whereas insurance service revenues are presented gross of insurance costs for financial reporting purposes. Acts as the basis to allocate resources to different functions and evaluates the effectiveness of our business strategies by each business function. Provides a measure, among others, used in the determination of incentive compensation for management. Is a component of Net Service Revenues. Provides a comparable basis of revenues on a net basis. Professional service revenues are presented net of client payroll costs whereas insurance service revenues are presented gross of insurance costs for financial reporting purposes. Promotes an understanding of our insurance services business by evaluating insurance service revenues net of our WSE related costs which are substantially pass-through for the benefit of our WSEs. Under GAAP, insurance service revenues and costs are recorded gross as we have latitude in establishing the price, service and supplier specifications. |
| Net Insurance Service Revenues | <ul style="list-style-type: none"> Insurance revenues less insurance costs. | <ul style="list-style-type: none"> We also sometimes refer to Net Insurance Service Margin, which is the ratio of Net Insurance Revenue to Insurance Service Revenue. |
| Adjusted EBITDA | <ul style="list-style-type: none"> Net income, excluding the effects of: <ul style="list-style-type: none"> income tax provision, interest expense, depreciation, amortization of intangible assets, and stock-based compensation expense. | <ul style="list-style-type: none"> Provides period-to-period comparisons on a consistent basis and an understanding as to how our management evaluates the effectiveness of our business strategies by excluding certain non-cash charges such as depreciation and amortization, and stock-based compensation recognized based on the estimated fair values. We believe these charges are either not directly resulting from our core operations or not indicative of our ongoing operations. Enhances comparisons to prior periods and, accordingly, facilitates the development of future projections and earnings growth prospects. Provides a measure, among others, used in the determination of incentive compensation for management. We also sometimes refer to Adjusted EBITDA margin, which is the ratio of Adjusted EBITDA to Net Service Revenue. |
| Adjusted Net Income | <ul style="list-style-type: none"> Net income, excluding the effects of: <ul style="list-style-type: none"> effective income tax rate ⁽¹⁾, stock-based compensation, amortization of intangible assets, non-cash interest expense ⁽²⁾, and the income tax effect (at our effective tax rate ⁽¹⁾) of these pre-tax adjustments. | <ul style="list-style-type: none"> Provides information to our stockholders and board of directors to understand how our management evaluates our business, to monitor and evaluate our operating results, and analyze profitability of our ongoing operations and trends on a consistent basis by excluding certain non-cash charges. |

MANAGEMENT'S DISCUSSION
AND ANALYSIS

| | | |
|--------------------------------------|---|--|
| Corporate Operating Cash Flows | <ul style="list-style-type: none"> • Net cash (used in) provided by operating activities, excluding the effects of: <ul style="list-style-type: none"> - Assets associated with WSEs (accounts receivable, unbilled revenue, prepaid expenses and other current assets) and - Liabilities associated with WSEs (client deposits, accrued wages, payroll tax liabilities and other payroll withholdings, accrued health benefit costs, accrued workers' compensation costs, insurance premiums and other payables, and other current liabilities). | <ul style="list-style-type: none"> • Provides information that our stockholders and management can use to evaluate our cash flows from operations independent of the current assets and liabilities associated with our WSEs. • Enhances comparisons to prior periods and, accordingly, used as a liquidity measure to manage liquidity between corporate and WSE related activities, and to help determine and plan our cash flow and capital strategies. |
|--------------------------------------|---|--|

Non-GAAP effective tax rate is 26% for 2019 and 2018, which excludes the income tax impact from stock-based (1) compensation, changes in uncertain tax positions, and nonrecurring benefits or expenses from federal legislative changes.

(2) Non-cash interest expense represents amortization and write-off of our debt issuance costs.

Reconciliation of GAAP to Non-GAAP Measures

The table below presents a reconciliation of Total revenues to Net Service Revenues:

| | Three Months Ended March 31, | 2019 | 2018 |
|-----------------------|---------------------------------------|-------|-------|
| (in millions) | | | |
| Total revenues | | \$934 | \$861 |
| Less: Insurance costs | | 683 | 641 |
| Net Service Revenues | | \$251 | \$220 |

The table below presents a reconciliation of Insurance service revenues to Net Insurance Service Revenues:

| | Three Months Ended March 31, | | |
|--------------------------------------|------------------------------------|-------|---|
| (in millions) | 2019 | 2018 | |
| Insurance service revenues | \$798 | \$732 | |
| Less: Insurance costs | 683 | 641 | |
| Net Insurance Service Revenues | \$115 | \$91 | |
| Net Insurance Service Revenue Margin | 14 | % 12 | % |

MANAGEMENT'S DISCUSSION
AND ANALYSIS

The table below presents a reconciliation of Net income to Adjusted EBITDA:

| | Three Months Ended March 31, | |
|--|------------------------------------|-------|
| (in millions) | 2019 | 2018 |
| Net income | \$63 | \$54 |
| Provision for income taxes | 20 | 13 |
| Stock-based compensation | 9 | 9 |
| Interest expense and bank fees | 5 | 6 |
| Depreciation and amortization of intangible assets | 11 | 9 |
| Adjusted EBITDA | \$108 | \$91 |
| Adjusted EBITDA Margin | 43 | %41 % |

The table below presents a reconciliation of Net income to Adjusted Net Income:

| | Three Months Ended March 31, | |
|--|---------------------------------------|------|
| (in millions) | 2019 | 2018 |
| Net income | \$63 | \$54 |
| Effective income tax rate adjustment | (1) | (4) |
| Stock-based compensation | 9 | 9 |
| Amortization of intangible assets | 1 | 1 |
| Non-cash interest expense | — | 1 |
| Income tax impact of pre-tax adjustments | (3) | (3) |
| Adjusted Net Income | \$69 | \$58 |

The table below presents a reconciliation of net cash used in operating activities to corporate operating cash flows:

| | Three Months Ended March 31, | |
|--|------------------------------------|---------|
| (in millions) | 2019 | 2018 |
| Net cash used in operating activities | \$(142) | \$(536) |
| Change in WSE related other current assets | 45 | 15 |
| Change in WSE related liabilities | 175 | 566 |
| Corporate Operating Cash Flows | \$78 | \$45 |

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Results of Operations

Operating Metrics

Worksite Employees (WSE)

We have historically experienced our highest volumes of changes in new and exiting clients during the first quarter of the year, as clients generally change their payroll service providers at the beginning of the payroll tax year. Average WSEs decreased 1% when comparing the first quarter of 2019 to the same period in 2018. During the first quarter of 2019, we saw an increase in attrition, related to the platform migration which was completed in the first quarter of 2018. This was partially offset by increased new sales and continued hiring within our installed base, especially in our Technology and Professional Services verticals.

Total WSEs can be used to estimate our beginning WSEs for the next period and, as a result, can be used as an indicator of our potential future success in growing our business and retaining clients.

Anticipated revenues for future periods can diverge from the revenue expectation derived from Average WSEs or Total WSEs due to pricing differences across our HR solutions and services and the degree to which clients and WSEs elect to participate in our solutions during future periods. In addition to focusing on growing our Average WSE and Total WSE counts, we also focus on pricing strategies, product participation and product differentiation to expand our revenue opportunities. We report the impact of client and WSE participation differences as a change in mix.

We are focused on growing our WSE base, including pursuing strategic acquisitions where appropriate, while improving our customer experience and continuing to manage attrition. We continued to invest in our efforts to enhance our customers' and WSEs' experiences, through operational and process improvements, and we have started to realize improved retention in some of our verticals.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Total Revenues

Our revenues consist of professional service revenues (PSR) and insurance service revenues (ISR). PSR represents fees charged to clients for processing payroll-related transactions on behalf of our clients, access to our HR expertise, employment and benefit law compliance services, and other HR-related services. ISR consists of insurance-related billings and administrative fees collected from clients and withheld from WSEs for workers' compensation insurance and health benefit insurance plans provided by third-party insurance carriers.

Monthly total revenues per Average WSE is a measure we use to monitor the success of our product and service pricing strategies. This measure increased 9% during the first quarter of 2019 compared to the same period in 2018.

We also analyze changes in total revenue with the following measures:

• Volume - the percentage change in period over period Average WSEs,

• Rate - the combined percentage changes in service fees for each vertical product and changes in service fees associated with each insurance service offering, and

• Mix - the change in composition of Average WSEs within our verticals combined with the composition of our enrolled WSEs within our insurance offerings.

The changes in total revenues attributed above to rate and mix during the first quarter of 2019, when compared to the same period in 2018, were primarily driven by increases in insurance services fees and health plan enrollment in our insurance service offerings.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Operating Income

Our operating income consists of total revenues less insurance costs and OE. Our insurance costs include insurance premiums for coverage provided by insurance carriers, reimbursement of claims payments made by insurance carriers or third-party administrators, and changes in accrued costs related to contractual obligations with our workers' compensation and health benefit carriers. Our OE consists primarily of our corporate employees' compensation related expenses which includes payroll, payroll taxes, SBC, bonuses, commissions and other payroll-and benefits-related costs.

The table below provides a view of the changes in components of operating income in the first quarters of 2019 and 2018.

(in
millions)

\$71 First Quarter 2018 Operating Income

+73 Higher total revenues primarily as a result of an increase in ISR fees and health plan enrollment.

-42 Higher insurance costs primarily as a result of an increase in health plan participation, or enrollment.

-20 Higher OE primarily as a result of growth in the number of our corporate employees and costs associated with initiatives to improve customer experience.

\$82 First Quarter 2019 Operating Income

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Professional Service Revenues

Our clients are billed either based on a fee per WSE per month per transaction or on a percentage of the WSEs' payroll. For those clients that are billed on a percentage of WSEs' payroll, as our clients' payrolls increase, our fees also increase. As such, payroll and payroll taxes processed, which includes recurring payrolls and non-recurring bonus payrolls, benefits, and associated payroll taxes may also be an indicator of our PSR growth.

Our vertical approach provides us the flexibility to offer our clients in different industries with varied services at different prices, which we believe potentially reduces the value of using Average WSE and Total WSE counts as indicators of future potential revenue performance.

We also analyze changes in PSR with the following measures:

- Mix - the change in composition of Average WSEs within our verticals,
- Rate - the percentage changes in fees for each vertical, and
- Volume - the percentage change in period over period Average WSEs.

The increase in PSR, shown above for the first quarter of 2019, reflects the ongoing change in the mix of our WSEs. During the first quarter of 2019, we continued to grow WSEs in our Technology, Financial Services, Professional Services, Life Sciences and Non-Profit verticals, while WSEs in our Main Street vertical declined.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Insurance Service Revenues

ISR consists of insurance services-related billings and administrative fees collected from clients and withheld from WSE payroll for health benefits and workers' compensation insurance provided by third-party insurance carriers.

We use the following measures to analyze changes in ISR:

- Volume - the percentage change in period over period Average WSEs,
- Rate - the percentage changes in fees associated with each of our insurance service offerings, and
- Mix - all other changes including the composition of our enrolled WSEs within our insurance service offerings (health plan enrollment).

The growth in ISR shown above for the first quarter of 2019 from changes in mix is due to higher health plan enrollment.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Insurance Costs

Insurance costs include insurance premiums for coverage provided by insurance carriers, reimbursement of claims payments made by insurance carriers or third-party administrators, and changes in accrued costs related to contractual obligations with our workers' compensation and health benefit carriers.

We use the following measures to analyze changes in insurance costs:

- Volume - the percentage change in period over period Average WSEs,
- Rate - the percentage changes in cost trend associated with each of our insurance service offerings, and
- Mix - all other changes including the composition of our enrolled WSEs within our insurance offerings (health plan enrollment).

The increase in insurance cost rates during the first quarter of 2019, as shown above, was primarily driven by an increase in medical cost trend, partially offset by lower administrative costs. We continue to experience favorable prior year development on our accrued workers' compensation costs, primarily due to lower than expected claim severity. The 6% increase in insurance costs attributed to change in mix during the first quarter of 2019 is consistent with the change in ISR mix. This increase is primarily due to higher health plan enrollment.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Net Service Revenues

NSR provides us with a comparable basis of revenues on a net basis, acts as the basis to allocate resources to different functions and helps us evaluate the effectiveness of our business strategies by each business function.

NISR margin expanded during the first quarter of 2019 to 14%, from 12% in the same period in 2018, due to an increase in ISR rates while managing our insurance costs.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Operating Expenses

OE includes cost of providing services (COPS), sales and marketing (S&M), general and administrative (G&A), systems development and programming (SD&P), and depreciation and amortization expenses (D&A).

We manage our operating expenses and allocate resources across different business functions based on percentage of NSR which has decreased to 67% in the first quarter of 2019 from 68% in the same period in 2018.

We had approximately 3,100 corporate employees as of March 31, 2019 in 59 offices across the U.S. Our corporate employees' compensation-related expenses represent a majority of our OE. Compensation costs for our corporate employees include payroll, payroll taxes, SBC, bonuses, commissions and other payroll- and benefits-related costs. Compensation expense for internal employees was and is primarily driven by our continued efforts to improve our customer experience. Compensation-related expense represented 65% and 65% of our OE in the first quarters of 2019 and 2018.

We expect our OE to increase for the foreseeable future from our continued efforts to improve our customer experience, our systems, processes, and internal controls. These expenses may fluctuate as a percentage of our total revenues from period-to-period depending on the timing of when expenses are incurred.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

We analyze and present our OE based upon the business functions COPS, S&M, G&A and SD&P and depreciation and amortization. The charts below provide a view of the expenses of the business functions. Dollars are presented in millions and percentages represent year-over-year change.

COPS increased in 2019, when compared to the same period in 2018, primarily due to increased headcount to support initiatives to improve the customer experience, enhancing our product offerings and process improvement initiatives.

S&M increased in 2019, when compared to the same period in 2018, driven by increase in headcount and lower commission expenses in 2018 a result of adoption of new revenue recognition guidance ASC Topic 606 in the first quarter of 2018.

G&A increased in 2019, when compared to the same period in 2018, primarily driven by increased headcount to support operations.

SD&P and D&A remained flat in 2019, when compared to the same period in 2018.

We break out the change in expenses that make up our OE in the chart below:

Other Income (Expense)

Other income (expense) consists primarily of interest and dividend income from investments and interest expense under our credit facility.

Interest income increased to \$6 million in the first quarter of 2019 from \$1 million in the same period in 2018 which was the result of a change in our investment strategy initiated in the second quarter of 2018 to improve our interest income.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

We intend to continue to execute our new investment strategy, which we expect will improve our interest income, net income, and our Adjusted EBITDA.

Interest expense, bank fees and other, remained consistent for the first quarters of 2019 and 2018.

Provision for Income Taxes

Our effective income tax rate was 24% and 20% for the first quarters of 2019 and 2018, respectively. The increase is primarily due to an increase in nondeductible compensation associated with stock-based compensation and a decrease in excludable income for state tax purposes.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Liquidity and Capital Resources

Liquidity

We believe that we have sufficient liquidity and capital resources to satisfy future requirements and meet our obligations to our clients, creditors and debt holders.

Included in our balance sheets are assets and liabilities resulting from transactions directly or indirectly associated with WSEs, including payroll and related taxes and withholdings, our sponsored workers' compensation and health insurance programs, and other benefit programs. Although we are not subject to regulatory restrictions that require us to do so, we distinguish and manage our corporate assets and liabilities separately from those current assets and liabilities held by us to satisfy our employer obligations associated with our WSEs as follows:

| (in millions) | March 31, 2019 | | | December 31, 2018 | | |
|---|----------------|---------|---------|-------------------|---------|---------|
| | Corporate | WSE | Total | Corporate | WSE | Total |
| Current assets: | | | | | | |
| Cash and cash equivalents | \$251 | \$— | \$251 | \$228 | \$— | \$228 |
| Investments | 56 | — | 56 | 54 | — | 54 |
| Restricted cash, cash equivalents and investments | 15 | 707 | 722 | 15 | 927 | 942 |
| Other current assets | 34 | 431 | 465 | 36 | 386 | 422 |
| Total current assets | \$356 | \$1,138 | \$1,494 | \$333 | \$1,313 | \$1,646 |
| | | | | | | |
| Total current liabilities | \$130 | \$1,138 | \$1,268 | \$112 | \$1,313 | \$1,425 |

| | | | | | | |
|-----------------|-------|-----|-------|-------|-----|-------|
| Working Capital | \$226 | \$— | \$226 | \$221 | \$— | \$221 |
|-----------------|-------|-----|-------|-------|-----|-------|

Working capital for WSE-related assets and liabilities

We designate funds to ensure that we have adequate current assets to satisfy our current obligations associated with WSEs. We manage our WSE payroll and benefits obligations through collections of payments from our clients which generally occurs two to three days in advance of client payroll dates. We regularly review our short-term obligations associated with our WSEs (such as payroll and related taxes, insurance premium and claim payments) and designate funds required to fulfill these short-term obligations, which we refer to as PFC. PFC is included in current assets as restricted cash, cash equivalents and investments.

We manage our sponsored benefit and workers' compensation insurance obligations by maintaining collateral funds in restricted cash, cash equivalents and investments. These collateral amounts are generally determined at the beginning of each plan year and we may be required by our insurance carriers to adjust our collateral balances when facts and circumstances change. We regularly review our collateral balances with our insurance carriers and anticipate funding further collateral in the future based upon our capital requirements. We classify our restricted cash, cash equivalents and investments as current and noncurrent assets to match against the anticipated timing of claims payments.

Working capital for corporate purposes

We use our available cash and cash equivalents to satisfy our operational and regulatory requirements and to fund capital expenditures. We believe that our existing corporate cash and cash equivalents and positive working capital will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Corporate working capital as of March 31, 2019 remained flat compared to working capital as of December 31, 2018.

Capital Resources

Sources of Funds

We believe that we can meet our present and reasonably foreseeable operating cash needs and future commitments through existing liquid assets, continuing cash flows from corporate operating activities, our borrowing capacity under our revolving credit facility and the potential issuance of debt or equity securities.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

We also have available a \$250 million revolving credit facility. The total unused portion of the revolving credit facility was \$234 million as of March 31, 2019.

Cash Flows

The following table presents our cash flow activities for the stated periods:

| (in millions) | Three Months Ended March 31, | | | | | |
|---|------------------------------|---------|---------|-----------|---------|---------|
| | 2019 | | | 2018 | | |
| | Corporate | WSE | Total | Corporate | WSE | Total |
| Net cash provided by (used in): | | | | | | |
| Operating activities | \$78 | \$(220) | \$(142) | \$45 | \$(581) | \$(536) |
| Investing activities | (11) | — | (11) | 2 | — | 2 |
| Financing activities | (47) | — | (47) | (19) | — | (19) |
| Net increase (decrease) in cash and cash equivalents, unrestricted and restricted | \$20 | \$(220) | \$(200) | \$28 | \$(581) | \$(553) |
| Cash and cash equivalents, unrestricted and restricted: | | | | | | |
| Beginning of period | 425 | 924 | 1,349 | 476 | 1,262 | 1,738 |
| End of period | \$445 | \$704 | \$1,149 | \$504 | \$681 | \$1,185 |
| Net increase (decrease) in cash and cash equivalents: | | | | | | |
| Unrestricted | \$23 | \$— | \$23 | \$(6) | \$— | \$(6) |
| Restricted | (3) | (220) | (223) | 34 | (581) | (547) |

Operating Activities

Components of net cash used in operating activities are as follows:

| (in millions) | Three Months Ended March 31, | | | | | |
|---|------------------------------|---------|---------|-----------|---------|---------|
| | 2019 | | | 2018 | | |
| | Corporate | WSE | Total | Corporate | WSE | Total |
| Net income | \$63 | \$— | \$63 | \$54 | \$— | \$54 |
| Depreciation and amortization | 18 | — | 18 | 10 | — | 10 |
| Stock-based compensation expense | 9 | — | 9 | 9 | — | 9 |
| Interest paid | (4) | — | (4) | (4) | — | (4) |
| Income tax payments, net | (1) | — | (1) | — | — | — |
| Changes in other operating assets | (4) | (45) | (49) | (2) | (15) | (17) |
| Changes in other operating liabilities | (3) | (175) | (178) | (22) | (566) | (588) |
| Net cash provided by (used in) operating activities | \$78 | \$(220) | \$(142) | \$45 | \$(581) | \$(536) |

Year-over-year fluctuation in net cash used in operating activities for WSE purposes was primarily driven by timing of client payments, payments of payroll and payroll taxes, and collateral funding and insurance claim activities. We expect the changes in restricted cash and cash equivalents to correspond to WSE cash provided by (or used in) operations as we manage our obligations associated with WSEs through restricted cash.

Our corporate operating cash flows increased to \$78 million in the first quarter of 2019 from \$45 million in the same period in 2018, primarily driven by increase in our net income and timing of paying our vendors and liabilities associated with our corporate activities.

MANAGEMENT'S DISCUSSION
AND ANALYSIS

Investing Activities

Net cash used in investing activities in the first quarter of 2019 increased, when compared to the same period of 2018, due to the purchases of investments, partially offset by proceeds from the sale and maturity of restricted investments, and cash paid for capital expenditures.

| (in millions) | Three Months Ended March 31, 2019 2018 | |
|--|--|-------|
| Investments: | | |
| Purchases of investments | (30) | — |
| Proceeds from sale and maturity of investments | 31 | 14 |
| Cash provided by investments | \$1 | \$ 14 |
| Capital expenditures: | | |
| Software and hardware | \$7 | \$ 6 |
| Office furniture, equipment and leasehold improvements | 5 | 6 |
| Cash used in capital expenditures | \$12 | \$ 12 |

Investments

We invest a portion of available cash in investment-grade securities with effective maturities less than five years that are classified on our condensed balance sheets as investments. As of March 31, 2019, we had approximately \$189 million in corporate investments.

We also invest funds held as collateral to satisfy our long-term obligation towards workers' compensation liabilities in U.S. long-term treasuries. These investments are classified on our condensed balance sheets as restricted cash, cash equivalents and investments. We review the amount and the anticipated holding period of these investments regularly in conjunction with our estimated long-term workers' compensation liabilities and anticipated claims payment trend. As of March 31, 2019, we held approximately \$1.3 billion in cash, cash equivalents and investments. Refer to Note 2 in this Form 10-Q for a summary of these funds.

Capital Expenditures

During the first quarter of 2019 and 2018, we continued to make investments in software and hardware, enhanced our existing products and technology platform. We also incurred expenses related to the build out of our corporate headquarters and our technology and client service centers. We expect capital investments in our software and hardware to continue in the future.

Financing Activities

Net cash used in financing activities in the first quarters of 2019 and 2018 consisted of our debt and equity-related activities.

| (in millions) | Three Months Ended March 31, | |
|---|------------------------------|-------|
| | 2019 | 2018 |
| Financing activities | | |
| Repurchase of common stock, net of issuance | \$ 41 | \$ 9 |
| Repayment of borrowings | 6 | 10 |
| Cash used in financing activities | \$ 47 | \$ 19 |

MANAGEMENT'S DISCUSSION
AND ANALYSIS

On February 6, 2019, our board of directors authorized a \$300 million incremental increase to our ongoing stock repurchase program initiated in May 2014, primarily to return value to our stockholders and to offset dilution from the issuance of stock under our equity-based incentive plan and employee stock purchase plan. During the first quarter of 2019, we repurchased 782,909 shares of our common stock for approximately \$38 million through our stock repurchase program. As of March 31, 2019, approximately \$337 million remained available for repurchase under all authorizations by our board of directors. We plan to use current cash and cash generated from ongoing operating activities to fund this share repurchase program.

Covenants

We were in compliance with the financial covenants under our credit facilities at March 31, 2019. For information on the covenants under our 2018 Credit Agreement, refer to Note 7 in Part II, Item 8. Financial Statements and Supplementary Data, of our Form 10-K.

Off-Balance Sheet Arrangements

There has been no material change in our off-balance sheet arrangements discussed in Part II, Item 7. Management's Discussion and Analysis of our 2018 Form 10-K.

Critical Accounting Policies, Estimates and Judgments

During the first quarter of 2019, we adopted ASC Topic 842. Refer to Note 1 in Item 1 of this Form 10-Q for disclosure of the changes related to this adoption. There have been no additional material changes to our critical accounting policies as discussed in our 2018 Form 10-K.

Recent Accounting Pronouncements

Refer to Note 1 in Item 1 of this Form 10-Q.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK AND CONTROLS AND PROCEDURES

Quantitative and Qualitative Disclosures About Market Risk

Our exposure to changes in interest rates relates primarily to our investment portfolio and outstanding floating rate debt. Changes in U.S. interest rates affect the interest earned on the Company's cash, cash equivalents and investments and the fair value of the investments, as well as interest costs associated with our debt.

Our cash equivalents consist primarily of money market mutual funds, which are not significantly exposed to interest rate risk. Our AFS marketable securities are subject to interest rate risk because these securities generally include a fixed interest rate. As a result, the market values of these securities are affected by changes in prevailing interest rates. We attempt to limit our exposure to interest rate risk and credit risk, as our investment policy defines minimum credit quality, liquidity, diversification and other requirements for eligible investments. Our AFS marketable securities consist of highly liquid, investment-grade securities. The risk of rate changes on investment balances was not significant at March 31, 2019.

At March 31, 2019, we had total outstanding long-term debt of \$407 million. Please refer to Note 7 in Part II, Item 8. Financial Statement and Supplementary Data, of our 2018 Form 10-K.

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have, with the participation of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2019, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act.

Based on the evaluation of our disclosure controls and procedures as of March 31, 2019, our CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of such date in ensuring that (i) information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the CEO and CFO, to allow timely decisions regarding required disclosure and (ii) such information is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms.

We have concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended March 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

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

FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| | March 31, 2019 | December 31, 2018 |
|--|----------------------|-------------------------|
| (in millions, except share and per share data) | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$251 | \$ 228 |
| Investments | 56 | 54 |
| Restricted cash, cash equivalents and investments | 722 | 942 |
| Accounts receivable, net | 12 | 11 |
| Unbilled revenue, net | 314 | 304 |
| Prepaid expenses | 58 | 48 |
| Other current assets | 81 | 59 |
| Total current assets | 1,494 | 1,646 |
| Restricted cash, cash equivalents and investments, noncurrent | 184 | 187 |
| Investments, noncurrent | 133 | 135 |
| Property & equipment, net | 82 | 79 |
| Operating lease right-of-use asset | 59 | — |
| Goodwill | 289 | 289 |
| Other intangible assets, net | 19 | 21 |
| Other assets | 85 | 78 |
| Total assets | \$2,345 | \$ 2,435 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable and other current liabilities | \$55 | \$ 45 |
| Long-term debt | 22 | 22 |
| Client deposits | 38 | 56 |
| Accrued wages | 369 | 352 |
| Accrued health insurance costs, net | 135 | 135 |
| Accrued workers' compensation costs, net | 67 | 67 |
| Payroll tax liabilities and other payroll withholdings | 550 | 729 |
| Operating lease liabilities | 16 | — |
| Insurance premiums and other payables | 16 | 19 |
| Total current liabilities | 1,268 | 1,425 |
| Long-term debt, noncurrent | 385 | 391 |
| Accrued workers' compensation costs, noncurrent, net | 156 | 158 |
| Deferred taxes | 65 | 68 |
| Operating lease liabilities, noncurrent | 54 | — |
| Other non-current liabilities | 11 | 18 |
| Total liabilities | 1,939 | 2,060 |
| Commitments and contingencies (see Note 6) | | |
| Stockholders' equity: | | |
| Preferred stock | — | — |
| (\$0.000025 par value per share; 20,000,000 shares authorized; no shares issued or outstanding at March 31, 2019 and December 31, 2018) | | |
| Common stock and additional paid-in capital | 651 | 641 |
| (\$0.000025 par value per share; 750,000,000 shares authorized; 70,079,747 and 70,596,559 shares issued and outstanding at March 31, 2019 and December 31, 2018) | | |

| | | |
|--|---------|----------|
| Accumulated deficit | (245) | (266) |
| Total stockholders' equity | 406 | 375 |
| Total liabilities & stockholders' equity | \$2,345 | \$ 2,435 |
| See accompanying notes. | | |

FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

| (in millions, except share and per share data) | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2019 | 2018 |
| Professional service revenues | \$136 | \$ 129 |
| Insurance service revenues | 798 | 732 |
| Total revenues | 934 | 861 |
| Insurance costs | 683 | 641 |
| Cost of providing services | 64 | 57 |
| Sales and marketing | 46 | 39 |
| General and administrative | 36 | 31 |
| Systems development and programming | 12 | 13 |
| Depreciation and amortization of intangible assets | 11 | 9 |
| Total costs and operating expenses | 852 | 790 |
| Operating income | 82 | 71 |
| Other income (expense): | | |
| Interest expense, bank fees and other | (5 |)(6 |
| Interest income | 6 | 2 |
| Income before provision for income taxes | 83 | 67 |
| Income tax expense | 20 | 13 |
| Net income | \$63 | \$ 54 |
| Comprehensive income | \$63 | \$ 54 |
| Net income per share: | | |
| Basic | \$0.91 | \$ 0.77 |
| Diluted | \$0.89 | \$ 0.75 |
| Weighted average shares: | | |
| Basic | 69,909,780 | 68,047,752 |
| Diluted | 71,247,422 | 74,821 |
| See accompanying notes. | | |

FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

| (in millions, except share data) | Common Stock and Additional Paid-In Capital | | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|--|---|--------|------------------------|---|----------------------------------|
| | Shares | Amount | | | |
| Balance at December 31, 2018 | 70,596,559 | \$ 641 | \$ (266) | \$ — | —\$ 375 |
| Net income | — | — | 63 | — | 63 |
| Issuance of common stock from restricted stock units and restricted stock awards | 286,719 | — | — | — | — |
| Issuance of common stock from exercise of stock options | 81,282 | 1 | — | — | 1 |
| Stock-based compensation expense | — | 9 | — | — | 9 |
| Repurchase of common stock | (782,909) | — | (38) | — | (38) |
| Awards effectively repurchased for required employee withholding taxes | (101,904) | — | (4) | — | (4) |
| Balance at March 31, 2019 | 70,079,747 | \$ 651 | \$ (245) | \$ — | —\$ 406 |

| (in millions, except share data) | Common Stock and Additional Paid-In Capital | | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|--|---|--------|------------------------|---|----------------------------------|
| | Shares | Amount | | | |
| Balance at December 31, 2017 | 69,818,392 | \$ 583 | \$ (377) | \$ — | \$ 206 |
| Net income | — | — | 54 | — | 54 |
| Other comprehensive income | — | — | — | (1) | (1) |
| Cumulative effect of accounting change | — | — | 3 | — | 3 |
| Issuance of common stock from vested restricted stock units | 610,266 | — | — | — | — |
| Issuance of common stock from exercise of stock options | 206,430 | 3 | — | — | 3 |
| Stock-based compensation expense | — | 9 | — | — | 9 |
| Repurchase of common stock | (160,033) | — | (8) | — | (8) |
| Awards effectively repurchased for required employee withholding taxes | (111,804) | — | (4) | — | (4) |
| Balance at March 31, 2018 | 70,363,251 | \$ 595 | \$ (332) | \$ (1) | \$ 262 |
| See accompanying notes. | | | | | |

FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------------|--------|
| (in millions) | 2019 | 2018 |
| Operating activities | | |
| Net income | 63 | 54 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 18 | 10 |
| Stock-based compensation | 9 | 9 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1 | 13 |
| Unbilled revenue | (9) |)11 |
| Prepaid expenses | (12) |)(11) |
| Other assets | (30) |)(24) |
| Accounts payable and other current liabilities | 9 | (15) |
| Client deposits | (19) |)(26) |
| Accrued wages | 17 | (15) |
| Accrued health insurance costs | — | (1) |
| Accrued workers' compensation costs | (2) |)(3) |
| Payroll taxes payable and other payroll withholdings | (180) |)(534) |
| Operating lease liabilities | (4) |)— |
| Other liabilities | (3) |)(4) |
| Net cash used in operating activities | (142) |)(536) |
| Investing activities | | |
| Purchases of marketable securities | (30) |)— |
| Proceeds from sale and maturity of marketable securities | 31 | 14 |
| Acquisitions of property and equipment | (12) |)(12) |
| Net cash (used in) provided by investing activities | (11) |)2 |
| Financing activities | | |
| Repurchase of common stock | (38) |)(8) |
| Proceeds from issuance of common stock | 1 | 3 |
| Awards effectively repurchased for required employee withholding taxes | (4) |)(4) |
| Repayment of debt | (6) |)(10) |
| Net cash used in financing activities | (47) |)(19) |
| Net decrease in unrestricted and restricted cash and cash equivalents | (200) |)(553) |
| Cash and cash equivalents, unrestricted and restricted: | | |
| Beginning of period | 1,349 | 1,738 |
| End of period | 1,149 | 1,185 |
| Supplemental disclosures of cash flow information | | |
| Interest paid | 4 | 4 |
| Income taxes paid, net | 1 | — |
| Supplemental schedule of noncash investing and financing activities | | |
| Payable for purchase of property and equipment | 5 | 2 |
| See accompanying notes. | | |

FINANCIAL STATEMENTS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

TriNet Group, Inc. (TriNet, or the Company, we, our and us), a professional employer organization, provides comprehensive human resources solutions for small to midsize businesses under a co-employment model. These HR solutions include multi-state payroll processing and tax administration, employee benefits programs, including health insurance and retirement plans, workers' compensation insurance and claims management, employment and benefit law compliance, and other HR-related services. Through the co-employment relationship, we are the employer of record for certain employment-related administrative and regulatory purposes for the worksite employees, including:

- compensation through wages and salaries,
- employer payroll-related tax payments,
- employee payroll-related tax withholdings and payments,
- employee benefit programs, including health and life insurance, and others, and
- workers' compensation coverage.

Our clients are responsible for the day-to-day job responsibilities of the WSEs.

We operate in one reportable segment. All of our service revenues are generated from external clients. Less than 1% of our revenue is generated outside of the U.S.

Basis of Presentation

These unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Rules and Regulations of the Securities and Exchange Commission. Certain information and note disclosures included in our annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, that are normal and recurring in nature, necessary for fair financial statement presentation. The results of operations for the three months ended March 31, 2019 are not necessarily indicative of the operating results anticipated for the full year. These Financial Statements should be read in conjunction with the audited Consolidated Financial Statements included in Part II, Item 8 Financial Statements and Supplementary Data of our Annual Report on Form 10-K for the year ended December 31, 2018 (2018 Form 10-K).

FINANCIAL STATEMENTS

Reclassifications

Certain prior year amounts have been reclassified to conform to current period presentation. Effects on the cash flow statement due to reclassifications are summarized below:

| (in millions) | For the Three Months Ended March 31, 2018 | |
|---|--|-------------------------------|
| | As previously reported | Reclassified As revised |
| Operating activities | | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | \$— | \$ 13 |
| Unbilled revenue | — | 11 |
| Prepaid income taxes | 13 | (13) |
| Prepaid expenses and other current assets | (9) | (2) |
| Workers' compensation collateral receivable | (1) | 1 |
| Other assets | (2) | (22) |
| Accounts payable and other current liabilities | (15) | — |
| Client deposits | — | (26) |
| Accrued wages | — | (15) |
| Accrued corporate wages | (9) | 9 |
| Accrued health insurance costs | — | (1) |
| Accrued workers' compensation costs | — | (3) |
| Workers' compensation loss reserves and other non-current liabilities | (6) | 6 |
| Payroll taxes payable and other payroll withholdings | — | (534) |
| Other liabilities | — | (4) |
| Worksite employee related assets | (1) | 1 |
| Worksite employee related liabilities | (5) | 5 |

Interest income previously classified in other income (expense), net is now presented in a new line item. Depreciation expense and amortization of intangible assets previously reported separately, are now presented together as depreciation and amortization of intangible assets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect certain reported amounts and related disclosures. Significant estimates include:

- liability for unpaid losses and loss adjustment expenses (accrued workers' compensation costs) related to workers' compensation and workers' compensation collateral receivable,
- accrued health insurance costs,
- liability for insurance premiums payable,
- valuation of the investment portfolio,
- impairments of goodwill and other intangible assets,
- income tax assets and liabilities, and
- liability for legal contingencies.

These estimates are based on historical experience and on various other assumptions that we believe to be reasonable from the facts available to us. Some of the assumptions are highly uncertain at the time of estimation. To the extent actual experience differs from the assumptions used, our consolidated financial statements could be materially affected.

Accrued Health Insurance Costs

We sponsor and administer a number of fully insured, risk-based employee benefit plans, including group health, dental, and vision as an employer plan sponsor under section 3(5) of the ERISA. In Q1 2019, the majority of our group health insurance costs related to risk-based plans. Our remaining group health insurance costs were for

guaranteed-cost policies.

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FINANCIAL STATEMENTS

Accrued health insurance costs are established to provide for the estimated unpaid costs of reimbursing the carriers for paying claims within the deductible layer in accordance with risk-based health insurance policies. These accrued costs include estimates for reported losses, plus estimates for claims incurred but not paid. We assess accrued health insurance costs regularly based upon independent actuarial studies that include other relevant factors such as current and historical claims payment patterns, plan enrollment and medical trend rates.

In certain carrier contracts we are required to prepay the expected claims activity for the subsequent period. These prepaid balances by agreement permit net settlement of obligations and offset the accrued health insurance costs or when the prepaid is in excess of our recorded liability the net asset position is included in prepaid expenses. As of March 31, 2019 and December 31, 2018, prepayments included in accrued health insurance costs were \$39 million and \$33 million, respectively.

Under certain policies, based on plan performance, we may be entitled to receive refunds of premiums which we recognize in accordance with the policy terms. We estimate these refunds based on premium and claims data and record as a reduction in the insurance costs on the consolidated statements of income and comprehensive income and prepaid expenses on the consolidated balance sheets. As of March 31, 2019 and December 31, 2018, there were no prepaid insurance premiums included in prepaid expenses.

Leases

We adopted ASU 2016-02 - Leases (ASC 842) effective January 1, 2019 using the optional transition method, under which we recognized the cumulative effects of initially applying the standard as an adjustment to the opening balance of retained earnings on January 1, 2019 with unchanged comparative periods. As part of this adoption, we elected the following practical expedients:

- not to reassess 1) whether any contracts that existed prior to adoption have or contain leases, 2) the classification of our existing leases or 3) initial direct costs for existing leases,

- to use the practical expedient of using hindsight to determine the lease terms and evaluate any impairments in right-of-use assets upon transition, and

- not separately record non-lease and lease components for all leases in which we act as a lessee.

We determine if a new contractual arrangement is a lease at contract inception. If a contract contains a lease, we evaluate whether it should be classified as an operating or a finance lease. If applicable as a lease, we record our lease liabilities and ROU assets based on the future minimum lease payments over the lease term and only include options to renew a lease in the minimum lease payments if it is reasonably certain that we will exercise that option. For certain leases with original terms of twelve months or less we recognize the lease expense as incurred and we do not recognize lease liabilities and ROU assets.

We measure our lease liabilities based on the future minimum lease payments discounted over the lease term. We determine our discount rate at lease inception using our incremental borrowing rate, which is based on our outstanding term debts that are collateralized by certain corporate assets. As of March 31, 2019, the weighted-average rate used in discounting the lease liability was 4.6%.

We measure our ROU assets based on the associated lease liabilities adjusted for any lease incentives such as tenant improvement allowances and classify operating ROU assets in other assets in our condensed consolidated balance sheet. For operating leases, we recognize expense for lease payments on a straight-line basis over the lease term.

FINANCIAL STATEMENTS

Recent Accounting Pronouncements

Recently adopted accounting guidance

Leases - In February of 2016, the FASB issued ASC 842, which replaced existing lease guidance under GAAP. Under this guidance, we recognize on our condensed balance sheet lease liabilities representing the present value of future lease payments and an associated right-of-use asset representing our right to use or control the use of specified assets for the lease term for any operating lease with a term greater than one year.

The impact of our adoption of ASC 842 did not have a material impact on our income statement or cash flow statement. The impact on our condensed balance sheets is as follows:

| (in millions) | March 31, 2019 | | |
|---|----------------|-------------------------|---------------------|
| | As reported | Balance | |
| | | Using Previous Standard | Increase (Decrease) |
| Balance sheet | | | |
| Assets | | | |
| Operating lease right-of-use assets | \$59 | \$ — | \$ 59 |
| Liabilities | | | |
| Operating lease liabilities | 16 | — | 16 |
| Operating lease liabilities, noncurrent | 54 | 11 | 43 |
| Equity | | | |
| Accumulated deficit | \$(245) | \$(245) | \$ — |

Recently issued accounting pronouncements

Credit Losses - In June 2016, the FASB issued ASU 2016-13 - Financial Instruments - Credit Losses (Topic 326), which requires financial assets to be presented at the net amount expected to be collected. We will be required to use forward-looking information when evaluating an allowance for our accounts receivable, unbilled revenue and other financial assets measured at amortized cost. Topic 326 also modifies the impairment guidance for available-for-sale debt securities to require an allowance for credit losses. We will adopt Topic 326 effective January 1, 2020 using a modified retrospective approach through a cumulative-effect adjustment to retained earnings. We are currently evaluating the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems.

FINANCIAL STATEMENTS

NOTE 2. CASH, CASH EQUIVALENTS AND INVESTMENTS

Under the terms of the agreements with certain of our workers' compensation and health benefit insurance carriers, we are required to maintain collateral in trust accounts for the benefit of specified insurance carriers and to reimburse the carriers' claim payments within our deductible layer. We invest a portion of the collateral amounts in marketable securities. We report the current and noncurrent portions of these trust accounts as restricted cash, cash equivalents and investments on the consolidated balance sheets.

We require our clients to prefund their payroll and related taxes and other withholding liabilities before payroll is processed or due for payment. This prefund is included in restricted cash, cash equivalents and investments as payroll funds collected, which is designated to pay pending payrolls, payroll tax liabilities and other payroll withholdings. We also invest available corporate funds, primarily in fixed income securities which meet the requirements of our corporate investment policy and are classified as available for sale (AFS).

Our total cash, cash equivalents and investments are summarized below:

| (in millions) | March 31, 2019 | | | | December 31, 2018 | | | |
|---|---------------------------|-------------------------------|------------------------|---------|---------------------------|-------------------------------|------------------------|---------|
| | Cash and cash equivalents | Available-for-sale securities | Collateral of deposits | Total | Cash and cash equivalents | Available-for-sale securities | Collateral of deposits | Total |
| Cash and cash equivalents | \$251 | \$ — | \$ — | \$251 | \$228 | \$ — | \$ — | \$228 |
| Investments | — | 56 | — | 56 | — | 54 | — | 54 |
| Restricted cash, cash equivalents and investments | | | | | | | | |
| Insurance carriers' security deposits | 15 | — | — | 15 | 15 | — | — | 15 |
| Payroll funds collected | 564 | — | — | 564 | 783 | — | — | 783 |
| Collateral for health benefits claims | 75 | — | — | 75 | 75 | — | — | 75 |
| Collateral for workers' compensation claims | 65 | 1 | — | 66 | 66 | 1 | — | 67 |
| Collateral to secure standby letter of credit | — | — | 2 | 2 | — | — | 2 | 2 |
| Total restricted cash, cash equivalents and investments | 719 | 1 | 2 | 722 | 939 | 1 | 2 | 942 |
| Investments, noncurrent | — | 133 | — | 133 | — | 135 | — | 135 |
| Restricted cash, cash equivalents and investments, noncurrent | | | | | | | | |
| Collateral for workers' compensation claims | 179 | 5 | — | 184 | 182 | 5 | — | 187 |
| Total | \$1,149 | \$ 195 | \$ 2 | \$1,346 | \$1,349 | \$ 195 | \$ 2 | \$1,546 |

NOTE 3. INVESTMENTS

All of our investment securities that have a contractual maturity date greater than three months are classified as AFS. The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of our investments as of March 31, 2019 and December 31, 2018 are presented below.

| (in millions) | March 31, 2019 | | | | December 31, 2018 | | | |
|--|----------------|------------------------|-------------------------|------------|-------------------|------------------------|-------------------------|------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Asset-backed securities | \$35 | \$ — | —\$ | —\$ 35 | \$33 | \$ — | —\$ | —\$ 33 |
| Corporate bonds | 100 | — | — | 100 | 99 | — | — | 99 |
| U.S. government agencies and government-sponsored agencies | 6 | — | — | 6 | 7 | — | — | 7 |
| U.S. treasuries | 47 | — | — | 47 | 46 | — | — | 46 |
| Exchange traded fund | 1 | — | — | 1 | 1 | — | — | 1 |
| Other debt securities | 6 | — | — | 6 | 9 | — | — | 9 |

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| | | | | | | |
|-------|---------|-----|---------|---------|-----|---------|
| Total | \$195\$ | —\$ | —\$ 195 | \$195\$ | —\$ | —\$ 195 |
|-------|---------|-----|---------|---------|-----|---------|

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FINANCIAL STATEMENTS

Gross unrealized losses as of March 31, 2019 and December 31, 2018 were not material.

Unrealized losses on fixed income securities are principally caused by changes in interest rates and the financial condition of the issuer. In analyzing an issuer's financial condition, we consider whether the securities are issued by the federal government or its agencies, whether downgrades by credit rating agencies have occurred, and industry analysts' reports. As we have the ability to hold these investments until maturity, or for the foreseeable future, no decline was deemed to be other-than-temporary. Actual maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

The fair value of debt investments by contractual maturity are shown below:

| | March 31, 2019 |
|-----------------------------------|----------------------|
| (in millions) | |
| One year or less | \$ 61 |
| Over one year through five years | 117 |
| Over five years through ten years | 7 |
| Over ten years | 9 |
| Total fair value | \$ 194 |

The gross proceeds from sales and maturities of AFS securities for the three months ended March 31, 2019 and March 31, 2018 are presented below.

| | Three Months Ended March 31, 2019 | 2018 |
|--------------------------------|--|-------|
| (in millions) | | |
| Gross proceeds from sales | \$ 14 | \$ — |
| Gross proceeds from maturities | 17 | 14 |
| Total | \$ 31 | \$ 14 |

FINANCIAL STATEMENTS

NOTE 4. LEASES

Our leasing activities predominantly consist of leasing office space that we occupy, which we have classified as operating leases. Our leases are comprised of fixed payments with remaining lease terms of 1 year to 9.5 years, some of which include options to extend for up to 15 years. As of March 31, 2019, we have not included any options to extend or cancel in the calculation of our lease liability or ROU asset. We do not have any significant residual value guarantees or restrictive covenants in our leases.

During the three months ended March 31, 2019, we recognized operating lease expense of \$5 million.

During the three months ended March 31, 2019, we paid \$5 million to reduce operating lease liabilities and recognized \$12 million in new operating lease liabilities in exchange for ROU assets.

As of March 31, 2019, the weighted average remaining lease term on our operating leases was 6.4 years. Future minimum lease payments as of March 31, 2019 and December 31, 2018 were the following:

| | March 31, 2019 ⁽²⁾ ⁽³⁾ | December 31, 2018 |
|-------------------------------------|--|----------------------|
| (in millions) | | |
| 2019 ⁽¹⁾ | \$ 15 | \$ 18 |
| 2020 | 17 | 17 |
| 2021 | 10 | 11 |
| 2022 | 8 | 9 |
| 2023 | 8 | 8 |
| 2024 | 5 | 5 |
| 2025 and thereafter | 19 | 20 |
| Total future minimum lease payments | \$ 82 | \$ 88 |
| Less: imputed interest | (12) | N/A ⁽⁴⁾ |
| Total operating lease liabilities | 70 | N/A ⁽⁴⁾ |
| Current portion | 16 | N/A ⁽⁴⁾ |
| Non-current portion | 54 | N/A ⁽⁴⁾ |

(1) The remaining payments as of March 31, 2019 exclude those made during the three months ended March 31, 2019.

(2) Presented in accordance with ASC 842, which excludes base payments of \$3 million for leases that do not yet have a commencement date.

(3) Presented in accordance with ASC 840.

(4) N/A - Not Applicable under ASC 840.

As of March 31, 2019, we have entered into two leases that have not yet commenced for terms of up to 5 years. Those leases will require minimum lease payments over their terms of \$3 million.

FINANCIAL STATEMENTS

NOTE 5. ACCRUED WORKERS' COMPENSATION COSTS

The following table summarizes the accrued workers' compensation cost activity for the three months ended March 31, 2019 and 2018:

| (in millions) | Three Months Ended March 31, | |
|--|---------------------------------------|-------|
| | 2019 | 2018 |
| Total accrued costs, beginning of period | \$238 | \$255 |
| Incurring | | |
| Current year | 19 | 20 |
| Prior years | (5) | (7) |
| Total incurred | 14 | 13 |
| Paid | | |
| Current year | (1) | — |
| Prior years | (15) | (18) |
| Total paid | (16) | (18) |
| Total accrued costs, end of period | \$236 | \$250 |

The following summarizes workers' compensation liabilities on the condensed consolidated balance sheets:

| (in millions) | March 31, 2019 | December 31, 2018 |
|---|-------------------|----------------------|
| Total accrued costs, end of period | \$ 236 | \$ 238 |
| Collateral paid to carriers and offset against accrued costs | (13) | (13) |
| Total accrued costs, net of carrier collateral offset | \$ 223 | \$ 225 |
| Payable in less than 1 year (net of collateral paid to carriers of \$4 and \$3 at March 31, 2019 and December 31, 2018, respectively) | \$ 67 | \$ 67 |
| Payable in more than 1 year (net of collateral paid to carriers of \$9 and \$10 at March 31, 2019 and December 31, 2018, respectively) | 156 | 158 |
| Total accrued costs, net of carrier collateral offset | \$ 223 | \$ 225 |

Incurring claims related to prior years represent changes in estimates for ultimate losses on workers' compensation claims. For the three months ended March 31, 2019, the change was primarily due to a decrease in estimate of ultimate losses related to older plan years and the recognition of current year development of ultimate losses.

As of March 31, 2019 and December 31, 2018, we had \$56 million and \$57 million, respectively, of collateral held by insurance carriers of which \$13 million and \$13 million, respectively, was offset against accrued workers' compensation costs as the agreements permit and are net settled against collateral held.

FINANCIAL STATEMENTS

NOTE 6. COMMITMENTS AND CONTINGENCIES

Contingencies

In August 2015, Howard Welgus, a purported stockholder, filed a putative securities class action lawsuit, *Welgus v. TriNet Group, Inc., et. al.*, under the Securities Exchange Act of 1934 in the U.S. District Court for the Northern District of California. The complaint was later amended in April 2016 and again in March 2017. On December 18, 2017, the district court granted TriNet's motion to dismiss the amended complaint in its entirety, without leave to amend. Plaintiff filed a notice of appeal of the district court's order on January 17, 2018. Plaintiff-Appellant filed his opening appeal brief before the Ninth Circuit Court of Appeals on April 27, 2018. TriNet filed a responsive brief on June 28, 2018. Plaintiff-Appellant filed his reply brief on August 20, 2018. Oral arguments were held before the Ninth Circuit Court of Appeals on March 14, 2019. On March 26, 2019, the Ninth Circuit Court of Appeals affirmed the district court's dismissal of the amended complaint in its entirety. Plaintiff-Appellant may appeal the decision by the Ninth Circuit Court of Appeals but to date has not done so. We are unable to reasonably estimate the possible loss or expense, or range of losses and expenses, if any, arising from this litigation.

We are and, from time to time, have been and may in the future become involved in various litigation matters, legal proceedings, and claims arising in the ordinary course of our business, including disputes with our clients or various class action, collective action, representative action, and other proceedings arising from the nature of our co-employment relationship with our clients and WSEs in which we are named as a defendant. In addition, due to the nature of our co-employment relationship with our clients and WSEs, we could be subject to liability for federal and state law violations, even if we do not participate in such violations. While our agreements with our clients contain indemnification provisions related to the conduct of our clients, we may not be able to avail ourselves of such provisions in every instance. We have accrued our current best estimates of probable losses with respect to these matters, which are individually and in aggregate immaterial to our consolidated financial statements.

While the outcome of the matters described above cannot be predicted with certainty, management currently does not believe that any such claims or proceedings or the above-mentioned securities class action will have a materially adverse effect on our consolidated financial position, results of operations, or cash flows. However, the unfavorable resolution of any particular matter or our reassessment of our exposure for any of the above matters based on additional information obtained in the future could have a material impact on our consolidated financial position, results of operations, or cash flows.

NOTE 7. STOCKHOLDERS' EQUITY

Equity-Based Incentive Plans

Our 2009 Equity Incentive Plan (the 2009 Plan) provides for the grant of stock awards, including stock options, RSUs, RSAs, and other stock awards. Shares available for grant as of March 31, 2019 were approximately 14 million.

Restricted Stock Units (RSUs) and Restricted Stock Awards (RSAs)

Time-based RSUs and RSAs generally vest over a four-year term. Performance-based RSUs and RSAs are subject to vesting requirements based on certain financial performance metrics as defined in the grant notice. Actual number of shares earned may range from 0% to 200% of the target award. Awards granted in 2019 and 2018 are based on a single-year performance period subject to subsequent multi-year vesting with 50% of the shares earned vesting in one year after the performance period and the remaining shares in the year after.

FINANCIAL STATEMENTS

The following table summarizes RSU and RSA activity under our equity-based plans for the three months ended March 31, 2019:

| | RSUs | | RSAs | |
|--------------------------------|-----------------|--|-----------------|--|
| | Number of Units | Weighted-Average Grant Date Fair Value | Number of Units | Weighted-Average Grant Date Fair Value |
| Nonvested at December 31, 2018 | 1,737,554 | \$ 32.83 | 346,792 | \$ 49.13 |
| Granted | 669,415 | 60.43 | — | — |
| Vested | (297,822) | 28.83 | (13,565) | 50.48 |
| Forfeited | (14,908) | 42.79 | (11,103) | 49.35 |
| Nonvested at March 31, 2019 | 2,094,239 | \$ 42.15 | 322,124 | \$ 49.20 |

Equity-Based Compensation

Stock-based compensation expense is measured based on the fair value of the stock award on the grant date and recognized over the requisite service period for each separately vesting portion of the stock award. Stock-based compensation expense and other disclosures for stock-based awards made to our employees pursuant to the equity plans was as follows:

| | Three Months Ended March 31, 2019 | | 2018 | |
|---|-----------------------------------|------|------|--|
| (in millions) | | | | |
| Cost of providing services | \$ 2 | \$ 2 | | |
| Sales and marketing | 1 | 2 | | |
| General and administrative | 5 | 4 | | |
| Systems development and programming costs | 1 | 1 | | |
| Total stock-based compensation expense | \$ 9 | \$ 9 | | |
| Income tax benefit related to stock-based compensation expense | \$ 3 | \$ 2 | | |
| Tax benefit realized from stock options exercise and similar awards | \$ 2 | \$ 6 | | |

Stock Repurchases
In February 2019, our board of directors authorized a \$300 million incremental increase to our ongoing stock repurchase program initiated in May 2014. During the three months ended March 31, 2019, we repurchased 782,909 shares of common stock for approximately \$38 million. As of March 31, 2019, approximately \$337 million remained available for further repurchases of our common stock under all authorizations from our board of directors under this program.

NOTE 8. INCOME TAXES

Our effective income tax rate was 24% and 20% for the three months ended March 31, 2019 and 2018, respectively. The increase is primarily due to an increase in nondeductible compensation associated with stock-based compensation and a decrease in excludable income for state tax purposes.

During the three months ended March 31, 2019, there was a de minimis change in our unrecognized tax benefits. The total amount of gross interest and penalties accrued was immaterial. It is reasonably possible the amount of the unrecognized benefit could increase or decrease within the next twelve months, which would have an impact on net income.

We are subject to tax in U.S. federal and various state and local jurisdictions, as well as Canada. We are not subject to any material income tax examinations in federal or state jurisdictions for tax years prior to January 1, 2012. We previously paid Notices of Proposed Assessments disallowing employment tax credits totaling \$11 million, plus interest of \$4 million in connection with the IRS examination of Gevity HR, Inc. and its subsidiaries, which was acquired by TriNet in June 2009. TriNet filed suit in June 2016 to recover the disallowed credits, and the issue is being resolved through the litigation process. TriNet and the IRS filed cross motions for summary judgment in this

matter in federal

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FINANCIAL STATEMENTS

district court on February 27, 2018. On September 17, 2018, the district court granted our motion for summary judgment and denied the IRS' motion. On January 18, 2019, the district court entered judgment in favor of TriNet in the amount of \$15 million, plus interest. The IRS filed a notice of appeal of the district court's decision on March 18, 2019. We will continue to vigorously defend our position through the litigation process.

NOTE 9. EARNINGS PER SHARE (EPS)

The following table presents the computation of our basic and diluted EPS attributable to our common stock:

| | Three Months Ended March 31, | |
|---|---------------------------------------|--------|
| (in millions, except per share data) | 2019 | 2018 |
| Net income | \$63 | \$54 |
| Weighted average shares of common stock outstanding | 70 | 70 |
| Basic EPS | \$0.91 | \$0.77 |
| Net income | \$63 | \$54 |
| Weighted average shares of common stock | 70 | 70 |
| Dilutive effect of stock options and restricted stock units | 1 | 2 |
| Weighted average shares of common stock outstanding | 71 | 72 |
| Diluted EPS | \$0.89 | \$0.75 |
| Common stock equivalents excluded from income per diluted share because of their anti-dilutive effect | 1 | 1 |

FINANCIAL STATEMENTS

NOTE 10. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

We use an independent pricing source to determine the fair value of our AFS. The independent pricing source utilizes various pricing models for each asset class; including the market approach. The inputs and assumptions for the pricing models are market observable inputs including trades of comparable securities, dealer quotes, credit spreads, yield curves and other market-related data.

We have not adjusted the prices obtained from the independent pricing service and we believe the prices received from the independent pricing service are representative of the prices that would be received to sell the assets at the measurement date (exit price).

The carrying value of the Company's cash equivalents and restricted cash equivalents approximate their fair values due to their short-term maturities. The Company's restricted investments are valued using quoted market prices and multiple dealer quotes.

We did not have any Level 3 financial instruments recognized in our balance sheet as of March 31, 2019 and December 31, 2018. There were no transfers between levels for the three months ended March 31, 2019 and 2018.

Fair Value Measurements on a Recurring Basis

The following table summarizes our financial instruments by significant categories and fair value measurement on a recurring basis as of March 31, 2019 and December 31, 2018.

| (in millions) | Level 1 | Level 2 | Total |
|--|------------|------------|-------|
| March 31, 2019 | | | |
| Cash equivalents: | | | |
| Money market mutual funds | \$74 | \$— | 74 |
| U.S. treasuries | — | 3 | 3 |
| Total cash equivalents | 74 | 3 | 77 |
| Investments: | | | |
| Asset-backed securities | — | 35 | 35 |
| Corporate bonds | — | 100 | 100 |
| U.S. government agencies and government-sponsored agencies | — | 6 | 6 |
| U.S. treasuries | — | 42 | 42 |
| Other debt securities | — | 6 | 6 |
| Total investments | — | 189 | 189 |
| Restricted cash equivalents: | | | |
| Money market mutual funds | 42 | — | 42 |
| Commercial paper | 19 | — | 19 |
| Total restricted cash equivalents | 61 | — | 61 |
| Restricted investments: | | | |
| U.S. treasuries | — | 5 | 5 |
| Exchange traded fund | 1 | — | 1 |
| Certificate of deposit | — | 2 | 2 |
| Total restricted investments | 1 | 7 | 8 |
| Total unrestricted and restricted cash equivalents and investments | \$136 | \$199 | \$335 |

FINANCIAL STATEMENTS

| (in millions) | Level 1 | Level 2 | Total |
|--|------------|------------|--------|
| December 31, 2018 | | | |
| Cash equivalents | | | |
| Money market mutual funds | \$ 4 | \$— | \$4 |
| U.S. treasuries | — | 1 | 1 |
| Total cash equivalents | 4 | 1 | 5 |
| Investments | | | |
| Asset-backed securities | — | 33 | 33 |
| Corporate bonds | — | 99 | 99 |
| U.S. government agencies and government-sponsored agencies | — | 7 | 7 |
| U.S. treasuries | — | 41 | 41 |
| Other debt securities | — | 9 | 9 |
| Total investments | — | 189 | 189 |
| Restricted cash equivalents: | | | |
| Money market mutual funds | 48 | — | 48 |
| Commercial paper | 20 | — | 20 |
| Total restricted cash equivalents | 68 | — | 68 |
| Restricted investments: | | | |
| U.S. treasuries | — | 5 | 5 |
| Exchange traded fund | 1 | — | 1 |
| Certificate of deposit | — | 2 | 2 |
| Total restricted investments | 1 | 7 | 8 |
| Total unrestricted and restricted cash equivalents and investments | \$ 73 | \$ 197 | \$ 270 |

Fair Value of Financial Instruments Disclosure

Long-Term Debt

The carrying value of our long-term debt at March 31, 2019 and December 31, 2018 was \$407 million and \$414 million, respectively. The estimated fair values of our debt payable at March 31, 2019 and December 31, 2018 were \$409 million and \$414 million, respectively. The fair value of our debt payable is estimated based on a discounted cash flow, which incorporates credit spreads and market interest rates to estimate the fair value and is considered Level 3 in the hierarchy for fair value measurement.

OTHER INFORMATION

Legal Proceedings

For the information required in this section, refer to Note 6 in the condensed consolidated financial statements and related notes included in this Form 10-Q.

Risk Factors

There have been no material changes in our risk factors disclosed in Part 1, Item 1A, of our 2018 Form 10-K.

Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

Not applicable.

(b) Use of Proceeds from Sales of Unregistered Securities

Not applicable.

(c) Issuer Purchases of Equity Securities

The following table provides information about our purchases of TriNet common stock during the quarter ended March 31, 2019:

| Period | Total Number of Shares Purchased ⁽¹⁾ | Weighted Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans ⁽²⁾ | Approximate Dollar Value (\$ millions) of Shares that May Yet be Purchased Under the Plans ⁽²⁾ |
|--------------------------------|---|---------------------------------------|---|---|
| January 1 - January 31, 2019 | 419,557 | \$ 43.29 | 395,300 | \$ 58 |
| February 1 - February 28, 2019 | 354,542 | \$ 50.75 | 277,300 | \$ 344 |
| March 1 - March 31, 2019 | 110,714 | \$ 61.00 | 110,309 | \$ 337 |
| Total | 884,813 | | 782,909 | |

(1) Includes shares surrendered by employees to us to satisfy tax withholding obligations that arose upon vesting of RSUs granted pursuant to approved plans.

(2) We repurchased a total of approximately \$38 million of our outstanding common stock during the period ended March 31, 2019.

As of March 31, 2019, we had approximately \$337 million remaining for repurchases under our stock repurchase program. Stock repurchases under the program are primarily intended to offset the dilutive effect of share-based employee incentive compensation. The purchases were funded from existing cash and cash equivalents balances.

Our stock repurchases are subject to certain restrictions under the terms of our 2018 Credit Agreement. For more information about our 2018 Credit Agreement and our stock repurchases, refer to Notes 7 and 9 in Part II, Item 8. Financial Statements and Supplementary Data of our 2018 Form 10-K.

Defaults Upon Senior Securities

Not applicable.

Mine Safety Disclosures

Not applicable.

Other Information

Not applicable.

OTHER INFORMATION

Exhibits

Incorporated herein by reference is a list of the exhibits contained in the Exhibit Index below.

EXHIBIT INDEX

| Exhibit No. | Exhibit | Incorporated by Reference | | | Filed Herewith |
|-------------|--|---------------------------|----------|-------------|----------------|
| | | Form No. | File No. | Filing Date | |
| 10.1 | <u>First Amended and Restated Employment Agreement between TriNet Group, Inc. and Olivier Kohler dated April 9, 2018.</u> | | | | X |
| 10.2 | <u>Form of Restricted Stock Unit Award Agreement and Restricted Stock Unit Grant Notice under the Amended and Restated 2009 Equity Incentive Plan</u> | | | | X |
| 10.3 | <u>Form of Performance-Based Restricted Stock Unit Award Agreement and Performance-Based Restricted Stock Unit Grant Notice under the Amended and Restated 2009 Equity Incentive Plan.</u> | | | | X |
| 31.1 | <u>Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| 31.2 | <u>Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| 32.1* | <u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| 101.INS | XBRL Instance Document | | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Linkbase Document | | | | |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | | | | |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | | | | |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | | | | |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | | | | |

*Document has been furnished, is deemed not filed and is not to be incorporated by reference into any of TriNet Group, Inc.'s filings under the Securities Act

of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language contained in any such filing.

SIGNATURES

SIGNATURES

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

TRINET GROUP, INC.

Date: April 29, 2019 By: /s/ Burton M. Goldfield
Burton M. Goldfield
Chief Executive Officer

Date: April 29, 2019 By: /s/ Richard Beckert
Richard Beckert
Chief Financial Officer

Date: April 29, 2019 By: /s/ Michael P. Murphy
Michael P. Murphy
Chief Accounting Officer