



# 2016 ANNUAL REPORT

Ultimate  
SOFTWARE





## Fellow Shareholders,

In 2016, we continued to set records across all areas of our business. We delivered a record \$781.3 million in total revenues, an increase of 26% over 2015, and a record \$654.2 million in recurring revenues, a 27% increase over 2015. In Sales, our collective team topped the record-setting fourth quarter they produced in 2015, contributing the best quarter for new business in our history in the fourth quarter of 2016. In 2016, our Services team activated more new customers over the span of a year than ever before, and along with our Development team, they created the total customer experience that resulted in our 2016 year-over-year customer retention rate of approximately 97%. We now have approximately 33 million people records in our cloud environment.

Sales exceeded our expectations in 2016, and as a result, we increased our hiring efforts, particularly in Services and Support. To accommodate our growth and maintain high-quality, rapid responsiveness in our infrastructure, we hired more than 1,000 new people in 2016. We also raised our employee retention rate to greater than 94% for 2016. Fortune magazine named Ultimate #1 on its list of *10 Best Large Workplaces in Technology* in January 2017, making this our second year to top the list. Our culture and this type of recognition have given us the ability to hire and retain some of the industry's most talented people.

In January 2017, I attended the annual meetings of our Enterprise, Mid-Market, and Strategic<sup>1</sup> sales teams, and they were very excited about our achievements and bullish about our future. The longevity of so many of our salespeople with us has been a major differentiator for years and continues to give us market leverage. Our marketing metrics reinforce our positive view of the future. Our metrics throughout 2016 showed that market desire for our solutions continued to grow at a healthy pace. Our fourth quarter in 2016 was our best quarter ever for responders from companies with 300 or more employees who indicated they are looking to buy a human capital management (HCM) solution in 12 months or less, and was a 46% increase over 2015's fourth quarter. For the 2016 year, we had a 23%

increase in looking-to-buy responders to marketing campaigns over 2015. On our website, we had a 34% increase in unique visitors for 2016 over the previous year, and we reached a milestone of more than 3 million unique visitors to our site for the year. We also had a 49% increase in number of attendees at our HR Workshops that we held across the United States in 2016 versus 2015.

Our Development team made significant headway with our strategy of adding new product feature-sets that meet the HR market's most pressing business objectives and bring us new opportunities to partner with our customers in more functional areas. In 2016, we rolled out our new UltiPro Learning solution, powered by the admired Schoox engine, to a segment of our sales organization, and by the end of December, we had sold 60 units. This new solution helps organizations transition from simply training employees to developing talent by making available to our customers a broad array of learning content and employee development tools at their convenience anytime online or via a mobile application. Business leaders can deploy our new learning programs and course structures across multiple teams, business units, and locations rapidly and enable team members to communicate with peers, instructors, or their managers through social tools such as communities, leaderboards, and newsfeeds. We rolled this solution out to the remainder of our sales force in the first quarter of 2017.

We acquired an award-winning cloud workforce intelligence provider, Kanjoya, in 2016, and based on this new technology, we introduced UltiPro Perception, giving our salespeople another solution to offer our customers. UltiPro Perception enables





businesses to collect, understand, and act on employee feedback from surveys. We also acquired Vestrics, a leading HR-focused predictive analytics platform with a history of measuring, predicting, and optimizing the business impact of HR- and talent-related investments and decisions for global businesses. Vestrics' technology had been recognized for its excellence in recent years by a number of analyst firms. (For additional details on these solutions, see *Business Highlights* in this 2016 Annual Report.)

Once again in 2016, end-user assessments, measured by a third-party, have validated the strength of our product solutions. G2 Crowd, an independent website that collects and analyzes thousands of software reviews from end users, produces software performance grids for many areas of HCM. In 2016, G2 Crowd identified Ultimate as a "leader" in its grids on Best Recruiting Solutions, Best Payroll, Best Core HR, Best HR Management Suite, and Best Performance Management solutions. In G2 Crowd's category called *Top 10 HR Management Suites Software for Enterprise*, UltiPro has the highest satisfaction rating from users—89% on January 2017's chart—and was based upon 1,843 HR-software-user reviews. In G2's category called *Top 8 Payroll Software for Enterprise*, UltiPro also had the highest satisfaction rating from users—again 89% for the same period and based upon 2,414 payroll-user reviews.<sup>2</sup>

In addition to Fortune recognizing Ultimate as #1 on its technology workplaces list, a number of other third-parties have recognized our success in 2016 and early in 2017. In January 2017, our UltiPro product won a Technology Gold Award in the *Best Advance in Online Coaching Tools* category from the Brandon Hall Group. In 2016, our Services team was named *Best Customer Service Department of the Year* at Network Products Guide's 11th Annual 2016 IT World Awards and also won the 2016 *STAR Award for Innovation in the Transformation of Support Services* at the SMB Level from the Technology Services Industry Association. Forbes ranked Ultimate #8 on its 2016 list of the *100 Most Innovative Growth*

*Companies*. Glassdoor and Battery Ventures ranked Ultimate #1 on its *25 Highest-Rated Public Cloud Computing Companies to Work For* list. Fortune ranked Ultimate #15 on its 2016 *100 Best Companies to Work For* list, marking our fifth consecutive year on this esteemed list, and ranked Ultimate on a number of its other 2016 lists: #3 on *50 Best Workplaces for Parents*, #4 on *100 Best Workplaces for Women*, #5 on *50 Best Workplaces for Diversity*, and #5 on both *Best Workplaces for Millennials* and *Best Workplaces for Gen Xers*.<sup>3</sup>

Our total customer count has risen to more than 3,700 organizations, giving Ultimate, we believe, the industry's largest customer base using a cloud-based HCM solution that unifies human resources, benefits, payroll, talent acquisition, talent management, compensation management, learning management, and time and labor management. In light of our high customer-satisfaction ratings and the continuing demand we see in our Enterprise, Mid-Market, and Strategic markets, we are confident we will achieve our 2017 objectives and our longer-range goals in 2018. We have the people in place, a strong culture of trust, and award-winning products and services to execute our vision. We remain focused, as always, on our "people first" strategy in serving both our customers and our employees.

We thank you, our shareholders, customers, employees, and partners, for your continuing support.

**SCOTT SCHERR**

Chairman of the Board,  
Chief Executive Officer, and Founder

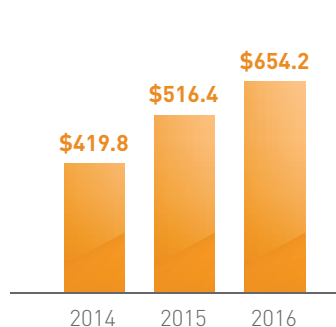


## FINANCIAL HIGHLIGHTS

OPERATING DATA (In Thousands)	2014	2015	2016
<b>Revenues</b>			
Recurring	\$419,771	\$516,400	\$654,199
Services	\$86,165	\$101,681	\$127,092
<b>TOTAL REVENUES</b>	<b>\$505,936</b>	<b>\$618,081</b>	<b>\$781,291</b>
Non-GAAP Operating Income*	\$101,670	\$126,768	\$157,550
As a % of Total Revenues	20%	21%	20%
BALANCE SHEET DATA (In Thousands)	2014	2015	2016
Cash and Cash Equivalents	\$108,298	\$109,325	\$73,773
Corporate Investments in Marketable Securities	\$10,156	\$20,058	\$24,088
<b>TOTAL ASSETS</b>	<b>\$1,190,298</b>	<b>\$1,465,569</b>	<b>\$1,152,581</b>
Deferred Revenue	\$109,705	\$145,727	\$173,976
Long-Term Debt Including Capital Lease Obligations, Net of Current Portion	\$3,759	\$3,665	\$3,985
Shareholders Equity	\$271,749	\$334,066	\$432,108

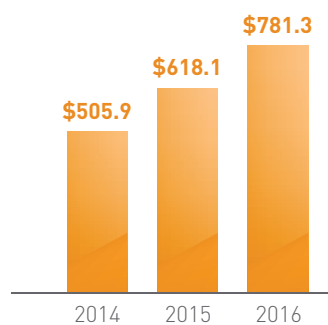
### RECURRING REVENUES

Dollars in Millions



### TOTAL REVENUES

Dollars in Millions



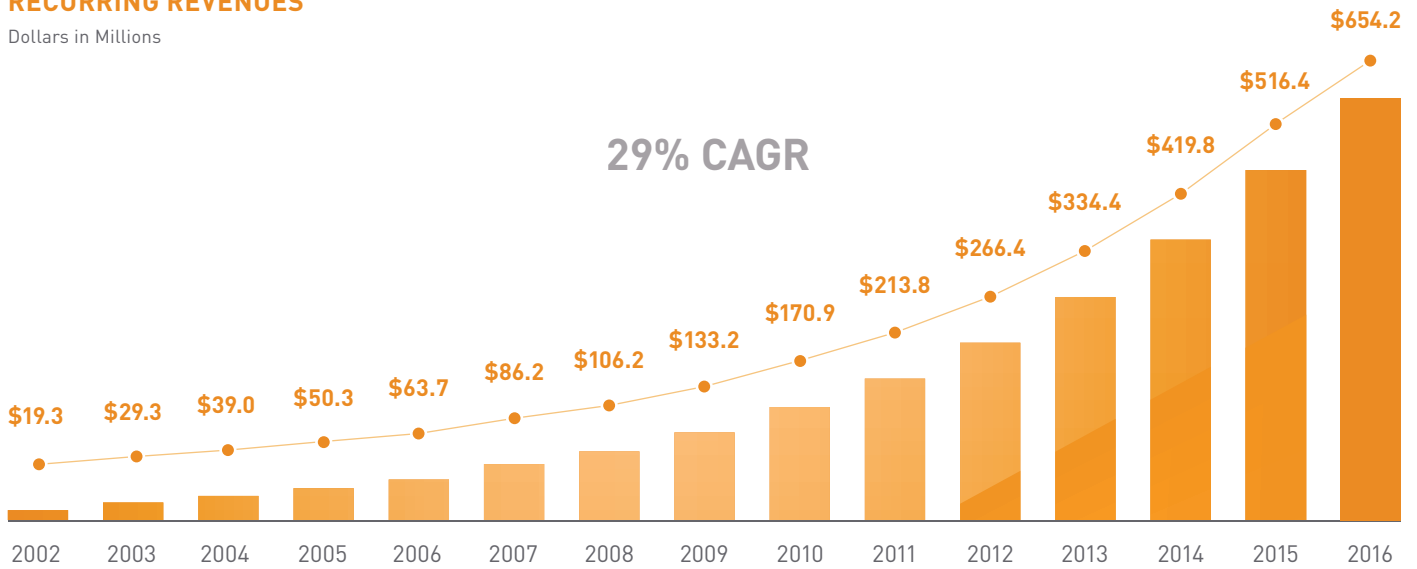
\* The term "Non-GAAP Operating Income" is a non-GAAP financial measure that is defined by Ultimate as operating income excluding stock-based compensation expense, amortization of acquired intangibles, and transaction costs related to business combinations. For more detail, see "Non-GAAP Measures" and "Unaudited Reconciliation of Non-GAAP Measures" in Note 4 of Notes at the end of this annual report.



## 15-YEAR FINANCIAL PERFORMANCE

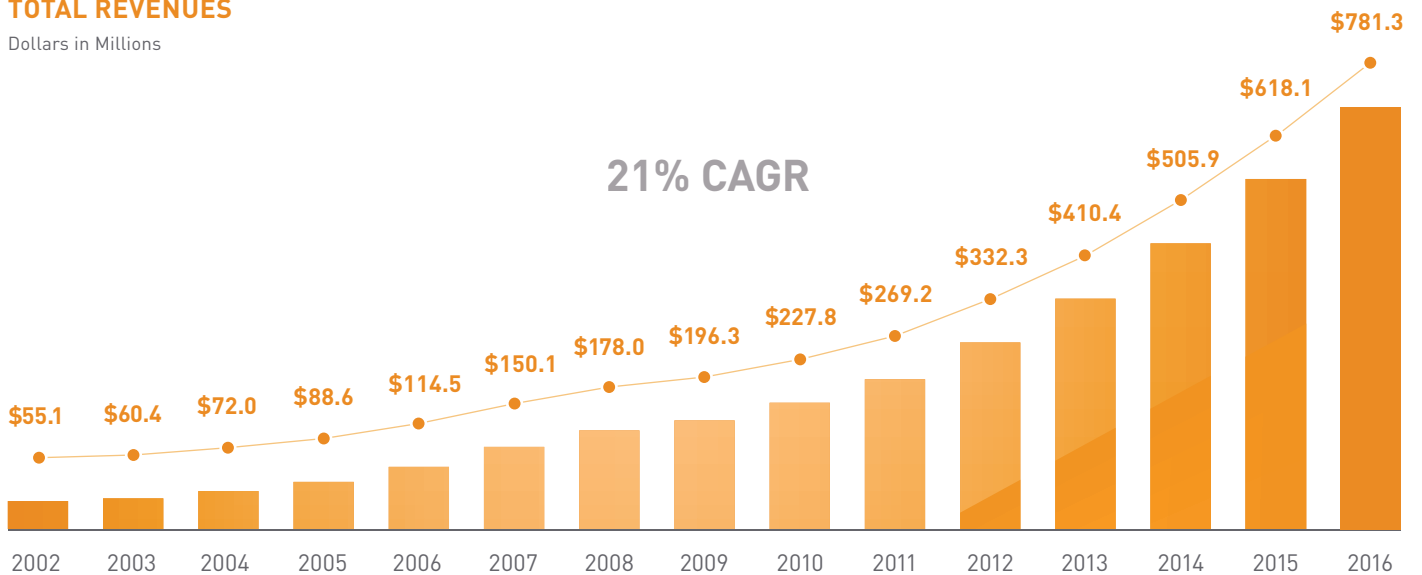
### RECURRING REVENUES

Dollars in Millions



### TOTAL REVENUES

Dollars in Millions



CAGR ON BOTH GRAPHS REPRESENTS ULTIMATE'S COMPOUNDED ANNUAL GROWTH RATE FROM 2002 THROUGH 2016.



## BUSINESS HIGHLIGHTS

1. Ultimate added more than 370 new features in UltiPro, with 80 of these growing out of customer ideas. Two key enhancement areas were analytics focused on improving the employee experience and mobile capabilities. The new analytics are both predictive and prescriptive. UltiPro's Leadership Actions in its Retention Predictor and High-Performer Predictor are based upon content from best-selling author and thought leader Simon Sinek and suggest actionable next steps across 16 categories of engagement for leaders to use for retaining and developing high-performing and high-potential individuals. UltiPro's mobile capabilities were expanded to include common actions taken by managers and employees, such as those associated with performance reviews, additional time-off, and profile changes.
2. Ultimate acquired Kanjoya, Inc., an award-winning cloud workforce intelligence provider. Based on this technology, Ultimate launched UltiPro Perception, a solution that enables businesses to collect, understand, and act on employee feedback from surveys and other sources. Our customers can now easily deploy engagement, pulse, and event-based surveys to uncover what employees are saying and feeling in real time. Through advanced "natural language processing" and "machine learning," UltiPro Perception transforms unstructured feedback into predictive analytics that can be used to improve employee experience and performance.
3. To expand our business analytics offerings further, Ultimate acquired Vestrics, a leading HR-focused predictive analytics platform with a history of measuring, predicting, and optimizing the business impact of HR- and talent-related investments and decisions for global businesses. Vestrics has been recognized by Gartner as a Cool Vendor of the Year, Aragon Research as a 2015 Hot Vendor, the ROI Institute for the most innovative approach to ROI, Bersin and Associates as a learning leader, and the Brandon Hall Group with an Excellence in Technology recognition in 2014 and 2015.
4. We released the UltiPro Global Payroll Connector to support our customers' international growth initiatives. Ultimate's pre-built connector to Celergo not only helps companies enter new countries with greater efficiency but also addresses their year-end tax filings and associated paperwork that is often more complicated overseas.
5. Ultimate was named a "Leader" in G2 Crowd's grids of Best Recruiting, Best Payroll, Best Core HR, Best HR Management Suite, and Best Performance Management solutions.
6. Ultimate was named *Best Customer Service Department of the Year* at Network Products Guide's 11th Annual 2016 IT World Awards. Network Products Guide's IT World Awards recognize technology achievements in every facet of the IT industry.
7. Ultimate won the 2016 *STAR Award for Innovation in the Transformation of Support Services* at the SMB Level from the Technology Services Industry Association. Ultimate was recognized for our conversion from a traditional tiered model of support to a collaborative (also called "tierless") support model that results in customer questions being answered more rapidly. Having multiple support experts "swarm" a customer question simultaneously in this collaborative model eliminates the time-consuming process of users waiting to be transferred to multiple tiers of support.

ALL ACHIEVEMENTS REFERENCED OCCURRED IN 2016 UNLESS OTHERWISE NOTED.

UltiPro is a registered trademark of The Ultimate Software Group, Inc. All other trademarks referenced are the property of their respective owners.



## BUSINESS HIGHLIGHTS

8. Ultimate was a Silver winner in the *Support Department of the Year* category in Best in Biz Awards 2016. Best in Biz Awards is the only independent business awards program judged by members of the press and industry analysts.
9. Ultimate was awarded a number of security- and privacy-related certifications, including: 1. TRUSTe privacy certification that verifies Ultimate's strict compliance with the EU-U.S. Privacy Shield, the framework that requires companies to meet stronger obligations to protect the personal data of Europeans and replaces the EU-U.S. Safe Harbor, with which Ultimate was already compliant; 2. ISO 27018, a standard published by the International Organization for Standardization (ISO) that establishes commonly accepted control objectives, controls, and guidelines that cloud service providers must implement to protect Personally Identifiable Information; and 3. Certification for adherence to the principles of the Asia Pacific Economic Cooperation's Cross Border Privacy Rules system, which encourage the development of appropriate information privacy protections.
10. Forbes ranked Ultimate #8 on its 2016 list of the *100 Most Innovative Growth Companies*.
11. Ultimate was ranked #1 on the *25 Highest-Rated Public Cloud Computing Companies to Work For* list by Glassdoor and Battery Ventures. The ranking was determined by employee reviews and company ratings shared on Glassdoor, an online jobs and career marketplace. Ultimate's CEO, Scott Scherr, has a 99% approval rating on Glassdoor and in June ranked #2 on Glassdoor's *Highest-Rated CEOs* list among leaders at large U.S. companies, a designation also based on anonymous reviews by company employees.
12. Fortune ranked Ultimate #15 on its 2016 *100 Best Companies to Work For* list, marking our fifth consecutive year on this esteemed list.
13. Fortune ranked Ultimate on several of its other 2016 lists: #3 on *50 Best Workplaces for Parents*, #4 on *100 Best Workplaces for Women*, #5 on *50 Best Workplaces for Diversity*, and #5 on both *Best Workplaces for Millennials* and *Best Workplaces for Gen Xers*.
14. Ultimate received a perfect score of 100% on the 2017 *Corporate Equality Index*, a national benchmarking survey and report on corporate policies and practices related to LGBT (Lesbian, Gay, Bisexual, and Transgender) workplace equality, administered by the Human Rights Campaign Foundation.
15. Ultimate was named to the Elite 8 of Achievers *50 Most Engaged Workplaces in North America*.
16. In January 2017, Fortune ranked Ultimate #1 on its *10 Best Large Workplaces in Technology* list, making this Ultimate's second consecutive year to top the list.
17. In January 2017, Ultimate won a Brandon Hall Group Technology Gold Award in the *Best Advance in Online Coaching Tools* category. The award recognizes UltiPro's Leadership Actions, which encourage proactive collaboration and communication between managers and employees to enhance employee engagement and retention.

ALL ACHIEVEMENTS REFERENCED OCCURRED  
IN 2016 UNLESS OTHERWISE NOTED.

UltiPro is a registered trademark of The Ultimate Software Group, Inc. All other trademarks referenced are the property of their respective owners.



## INVESTOR INFORMATION

### SHAREHOLDERS' MEETING

Monday, May 15, 2017, 10 a.m. EDT  
2000 Ultimate Way, Weston, FL 33326

*Formal notice will be sent to shareholders of record as of March 21, 2017.*

### ANNUAL REPORT AND FORM 10-K

Ultimate's 2016 Annual Report, including the 2016 Form 10-K filed with the U.S. Securities and Exchange Commission for the fiscal year ended December 31, 2016, is available electronically as a PDF on our website at [www.ultimatesoftware.com](http://www.ultimatesoftware.com). Printed copies of the 2016 Form 10-K are available without charge upon request to: Ultimate Software, Investor Relations Department, 2000 Ultimate Way, Weston, Florida 33326.

### SAFE HARBOR STATEMENT

Statements in this Annual Report relating to future plans, results, performance, expectations, achievements, and the like are considered "forward-looking statements." These forward-looking statements involve known and unknown risks and are subject to change based on various factors and uncertainties that may cause actual results to differ materially from these expressed or implied by these statements. Factors and uncertainties that may cause actual results to differ include, but are not limited to, the risks disclosed in Ultimate's filings with the U.S. Securities and Exchange Commission, including in Ultimate's 2016 Form 10-K. Ultimate undertakes no obligation to revise or update any forward-looking statements.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP

### LEGAL COUNSEL

Stroock & Stroock & Lavan LLP  
New York, New York

### TRANSFER AGENT AND REGISTRAR

Computershare Trust Company, N.A.  
P.O. Box 43078  
Providence, Rhode Island 02940-3078  
877.282.1168  
[www.computershare.com](http://www.computershare.com)

UltiPro is a registered trademark of The Ultimate Software Group, Inc. All other trademarks referenced are the property of their respective owners.

### INVESTOR RELATIONS

For additional information about Ultimate, contact Mitchell K. Dauerman, 954.331.7369.

### STOCK TRADING

Ultimate's common stock is traded on the Nasdaq Global Select Market under the symbol, ULTI.

### COMPANY ADDRESS

Ultimate Software  
2000 Ultimate Way  
Weston, Florida 33326  
800.432.1729 or 954.331.7000  
[www.ultimatesoftware.com](http://www.ultimatesoftware.com)

### COMPANY PROFILE

Ultimate is a leading provider of cloud-based human capital management solutions, with approximately 33 million people records in the cloud. Ultimate's award-winning UltiPro delivers HR, payroll, talent, and time and labor management solutions that connect people with the information they need to work more effectively. Founded in 1990, Ultimate is headquartered in Weston, Florida, and employs more than 3,700 professionals. In 2017, Fortune ranked Ultimate #1 on its list of the *10 Best Workplaces in Technology*, Ultimate's second year to top this list, and the Brandon Hall Group honored Ultimate with a Gold Award in Technology. In 2016, Fortune ranked Ultimate #15 on its *100 Best Companies to Work For* list, the fifth consecutive year to be ranked in the top 25. Ultimate was also ranked #1 on Glassdoor's list of *25 Highest-Rated Public Cloud Companies To Work For*, #8 on Forbes' list of the *100 Most Innovative Growth Companies*, and ranked #1 in customer satisfaction in G2 Crowd's Summer 2016 Core HR Software Grid report, based on user reviews. Ultimate has approximately 3,700 customers with employees in 160 countries, including Bloomin' Brands, Culligan International, Feeding America, Major League Baseball, Red Roof Inn, SUBWAY, Texas Roadhouse, and Yamaha Corporation of America.





## DIRECTORS AND OFFICERS

---

### BOARD OF DIRECTORS

**SCOTT SCHERR**

Chairman, Chief Executive Officer,  
and Founder

**MARC D. SCHERR**

Vice Chairman and Chief Operating Officer

**JAMES A. FITZPATRICK, JR.**

Partner  
Hogan Lovells US LLP

**LEROY A. VANDER PUTTEN**

Former Executive Chairman  
The Insurance Center, Inc.

**ROBERT A. YANOVER**

Former President  
Computer Leasing Corporation

**RICK A. WILBER**

Former President  
Lynn's Hallmark Cards

**AL LEITER**

President  
Leiter's Landing

### EXECUTIVE OFFICERS

**SCOTT SCHERR**

Chairman, Chief Executive Officer,  
and Founder

**MARC D. SCHERR**

Vice Chairman and Chief Operating Officer

**MITCHELL K. DAUERMAN**

Executive Vice President, Chief Financial  
Officer, and Treasurer



## NOTES

<sup>1</sup>As of 2017, Ultimate's Enterprise sales team targets companies with 2,501 or more employees, including companies with 100,000 employees and more; our Mid-Market sales team targets companies with 501 to 2,500 employees; and our Strategic sales team targets companies with 100 to 500 employees.

<sup>2</sup>All G2 Crowd assessments that we reference were found on its website, g2crowd.com, on January 30, 2017, and we acknowledge that G2 scores are calculated on a real-time basis and could change when additional user reviews are posted subsequent to January 30, 2017.

<sup>3</sup>For more detail on awards and recognition, see the Business Highlights section of this report.

#### **4 NON-GAAP MEASURES**

This Annual Report contains non-GAAP financial measures. Ultimate believes that non-GAAP measures of financial results provide useful information to management and investors regarding certain financial and business trends relating to Ultimate's financial condition and results of operations. Ultimate's management uses these non-GAAP results to compare Ultimate's performance to that of prior periods for trend analyses, for purposes of determining executive incentive compensation, and for budget and planning purposes. These measures are used in monthly financial reports prepared for management and in quarterly financial reports presented to Ultimate's Board of Directors. These measures may be different from non-GAAP financial measures used by other companies.

These non-GAAP measures should not be considered in isolation or as an alternative to such measures determined in accordance with the generally accepted accounting principles in the United States (GAAP). The principal limitation of these non-GAAP financial measures is that they exclude significant expenses that are required by GAAP to be recorded. In addition, they are subject to inherent limitations as they reflect the exercise of judgment by management about which expenses are excluded from the non-GAAP financial measures.

To compensate for these limitations, Ultimate presents its non-GAAP financial measures in connection with its GAAP results. Ultimate strongly urges investors and potential investors in Ultimate's securities to review the reconciliation of its non-GAAP financial measures to the comparable GAAP financial measures included in this Annual Report (under the caption "Unaudited Reconciliation of Non-GAAP Financial Measures") and not rely on any single financial measure to evaluate its business.

Ultimate presents the following non-GAAP financial measure in this Annual Report: non-GAAP operating income and non-GAAP operating income, as a percentage of total revenues (or non-GAAP operating margin). We exclude the following items from these non-GAAP financial measures, as appropriate:

Stock-based compensation expense. Ultimate's non-GAAP financial measures exclude stock-based compensation expense, which consists of expenses for stock options and stock and stock unit awards recorded in accordance with Accounting Standards Codification 718, "Compensation – Stock Compensation." For the years ended December 31, 2016, 2015 and 2014, stock-based compensation expense was \$113.9 million, \$82.4 million and \$46.2 million on a pre-tax basis, respectively. Stock-based compensation expense is excluded from the non-GAAP financial measures because it is a non-cash expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates the comparison of results of ongoing operations for current and future periods with such results from past periods.

Amortization of acquired intangible assets. In accordance with GAAP, operating expenses include amortization of acquired intangible assets over the estimated useful lives of such assets. For the years ended December 31, 2016, 2015 and 2014, the amortization of acquired intangible assets was \$1.1 million, \$1.0 million and \$1.1 million, respectively. Amortization of acquired intangible assets is excluded from Ultimate's non-GAAP financial measures because it is a non-cash expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates comparisons to its historical operating results and to the results of other companies in the same industry, which have their own unique acquisition histories.



## NOTES

Transaction costs related to business combinations. In accordance with GAAP, operating expenses include transaction costs for third-party professional services received in connection with business combinations. As we do not acquire or dispose of businesses on a predictable basis, the terms of each business combination are unique and can vary significantly from other business combinations. Significant expenses can be incurred in connection with a business combination that we would not have otherwise incurred in the periods presented as part of our continuing operations. For the years ended December 31, 2016, the transactions costs incurred related to business combinations was \$0.9 million. There were no transaction costs incurred related to business combinations for the years ended December 31, 2015, and 2014. Transaction costs related to business combinations are excluded from Ultimate's non-GAAP financial measures because it is an expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates comparisons to its historical operating results and to the results of other companies in the same industry, which have their own unique business combination histories.

### UNAUDITED RECONCILIATION OF NON-GAAP MEASURES

(Dollars in Thousands)

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Operating income	\$54,343	\$43,318	\$41,684
Operating income, as a % of total revenues	11%	7%	5%
Add back:			
Non-cash stock-based compensation expense	46,185	82,416	113,877
Non-cash amortization of acquired intangible assets	1,142	1,034	1,115
Transaction costs related to business combinations	—	—	874
Non-GAAP operating income	<u>\$101,670</u>	<u>\$126,768</u>	<u>\$157,550</u>
Non-GAAP operating income, as a % of total revenues	<u>20%</u>	<u>21%</u>	<u>20%</u>

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 0-24347

**The Ultimate Software Group, Inc.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**2000 Ultimate Way,**

**Weston, FL**

(Address of principal executive offices)

**65-0694077**

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

**33326**

(Zip Code)

**Registrant's telephone number, including area code:**  
**(954) 331-7000**

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

**Title of Each Class:**

**Name of Each Exchange on which Registered:**

Common Stock, par value \$.01 per share

The Nasdaq Stock Market LLC

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

None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The aggregate market value of Common Stock, par value \$.01 per share, held by non-affiliates of the Registrant, based upon the closing sale price of such shares on the NASDAQ Global Select Market on June 30, 2016 was approximately \$5.7 billion.

As of February 20, 2017, there were 29,663,502 shares of the Registrant's Common Stock, par value \$.01, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement for the 2017 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

# THE ULTIMATE SOFTWARE GROUP, INC.

## INDEX

	<u>Page(s)</u>
Forward-Looking Statements	2
<b>PART I</b>	
Item 1. Business	2
Item 1A. Risk Factors	14
Item 1B. Unresolved Staff Comments	22
Item 2. Properties	22
Item 3. Legal Proceedings	22
Item 4. Mine Safety Disclosures	22
<b>PART II</b>	
Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities	22
Item 6. Selected Financial Data	25
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	27
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	42
Item 8. Financial Statements and Supplementary Data	44
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	77
Item 9A. Controls and Procedures	77
Independent Registered Public Accounting Firm's Report on Internal Control over Financial Reporting	79
Item 9B. Other Information	80
<b>PART III</b>	
Item 10. Directors, Executive Officers and Corporate Governance	80
Item 11. Executive Compensation	83
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	83
Item 13. Certain Relationships and Related Transactions, and Director Independence	83
Item 14. Principal Accountant Fees and Services	83
<b>PART IV</b>	
Item 15. Exhibits and Financial Statement Schedules	83
Signatures	86

## FORWARD-LOOKING STATEMENTS

*This Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (this "Form 10-K") of The Ultimate Software Group, Inc. and subsidiaries ("Ultimate," "Ultimate Software," "we," "us" or "our") may contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent our expectations or beliefs, including, but not limited to, our expectations concerning our operations and financial performance and condition. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to certain risks and uncertainties that are difficult to predict. Ultimate's actual results could differ materially from those contained in the forward-looking statements due to risks and uncertainties associated with fluctuations in our quarterly operating results, concentration of our product offerings, development risks involved with new products and technologies, competition, our contractual relationships with third parties, contract renewals with business partners, compliance by our customers with the terms of their contracts with us, and other factors disclosed in Ultimate's filings with the Securities and Exchange Commission. Other factors that may cause such differences include, but are not limited to, those discussed in this Form 10-K, including the risk factors set forth in Item 1A. Ultimate undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

*UltiPro® and its related design are registered trademarks of Ultimate in the United States. This Form 10-K also includes names, trademarks, service marks and registered trademarks and service marks of companies other than Ultimate.*

## PART I

### Item 1. Business

#### Overview

Ultimate Software is a leading cloud provider of people management solutions, often referred to as human capital management ("HCM"). Ultimate's UltiPro product suite ("UltiPro") is a comprehensive, engaging solution that has human resources ("HR"), payroll, and benefits management at its core and includes global people management, available in 14 languages with more than 35 country-specific localizations. The solution is delivered via software-as-a-service ("SaaS") to organizations based in the United States and Canada, including those with global workforces. At the close of 2016, we had approximately 3,700 organizations as customers and approximately 33 million people records in our HCM cloud. We attained our leadership position, we believe, through our focus on unified HCM, people-centric product design, cloud technology, and strong customer relationships.

UltiPro is designed to deliver the functionality businesses need to manage the complete employee life cycle from recruitment to retirement and to facilitate employee engagement with their employers and each other. The solution includes unified feature sets for talent acquisition and onboarding, HR management and compliance, benefits management and online enrollment, payroll, performance management, employee engagement surveying, compensation management with salary planning, budgeting, and development of incentive plans, succession management, learning management, reporting and analytical decision-making and predictive tools, and time and attendance. UltiPro has role-based features for HR professionals, executives, managers, administrators, and employees whether they are in or out of the office, including access to business-critical information on mobile devices such as the iPhone, iPad, and other smartphones and tablets.

Our customers tell us that UltiPro helps them to streamline talent management, HR and payroll processes to significantly reduce administrative and operational costs while also empowering them to manage the talent in their workforces more strategically. UltiPro provides our customers tools to analyze workforce trends for better decision making, identify high-performing talent within their organizations, predict who high-performers will be with a high degree of accuracy, find critical information quickly and perform routine business activities efficiently.

Our cloud offering of UltiPro provides Web-based access to comprehensive HCM functionality for organizations that want to simplify delivery and support of their business applications. We have found that UltiPro is attractive to companies that want to focus on their core competencies to increase sales and profits while we, through UltiPro, supply and manage the hardware, infrastructure, ongoing maintenance and backup services for our customers.

We market our UltiPro solutions primarily to enterprise companies, which we define as organizations with 2,501 or more employees, including those with 10,000 or more employees; mid-market companies, which we define as those having 501-2,500 employees; and strategic market companies, which we define as those having 100-500 employees. Our mid-market and strategic customers have access to nearly all the features that our larger enterprise companies have through UltiPro, plus a bundled services package. Since many companies in the mid- and strategic markets do not have information technology ("IT")

staff on their premises to help with system deployment or ongoing management issues, we have created a bundled services package to give these customers a high degree of convenience by handling system configuration, business rules, and other situations for them “behind the scenes.” UltiPro is marketed primarily through our enterprise, mid-market, and strategic direct sales teams.

## **Cloud Computing Model**

Cloud computing is the current terminology for describing the delivery of SaaS. Market acceptance of cloud computing for mission critical enterprise applications has become increasingly common in recent years since software can be delivered cost-effectively, reliably, and securely to businesses over the Internet without the need for customers to purchase supporting software and hardware for an on-premise system or the need to keep IT people on staff to monitor and upgrade such a system.

We introduced our first subscription-based service solution over the Internet in December of 2000, and we began marketing our first multi-tenant SaaS HCM to enterprise companies in 2002. Since that time, we have significantly expanded our HCM offerings and enhanced our foundational technologies. Today, we develop our solutions using the latest advances in cloud computing and provide our customers with solutions that are highly functional, easy to use, configurable, and fast. Our cloud model is based on a multi-tenant architecture that is both open and secure with support for user experiences on both desktop and mobile devices. Our customers that have moved away from traditional on-premise software to our cloud-based service applications benefit by substantially reducing the cost and complexity typical of on-premise software implementations, customizations, and upgrades. Through cloud computing, we supply and manage the hardware, infrastructure, ongoing maintenance, and backup services for our customers. We install the latest version of our software for our customers, thereby reducing their need to buy and maintain their own IT resources. As a part of our cloud model, we also provide activation and training services to our customers as well as support services.

We provide our hardware, infrastructure, ongoing maintenance and backup services at four data centers: one located near Atlanta, Georgia, one near Phoenix, Arizona, one near Toronto, Canada, and the fourth near Vancouver, Canada. Our data center facilities are owned and operated by independent third parties, who provide redundant power, bandwidth, and physical security. Ultimate employees deploy, monitor, and manage our hardware and software systems in accordance with our security and data privacy policies, which are subject to examination by an independent third-party.

## **Market Share**

Based on our customer counts and market data from Hoover's/Dun & Bradstreet as of January 3, 2017, we estimate our approximate share of the total available market (TAM) at the close of 2016 to be 7 percent for enterprise companies, 9 percent for mid-market companies, and 1 percent for companies in the strategic market.

## **Company Information**

Ultimate is a Delaware corporation formed in April 1996 to assume the business and operations of The Ultimate Software Group, Ltd. (the “Partnership”), a limited partnership founded in 1990. During August 2006, Ultimate formed a wholly-owned subsidiary, The Ultimate Software Group of Canada, Inc. (“Ultimate Canada”), to accommodate our operations in Canada. During February 2015, Ultimate formed a wholly-owned subsidiary, The Ultimate Software Group of Asia, PTE. LTD. There were no material assets or revenues in Canada or Singapore as of or for the year ended December 31, 2016. Ultimate's headquarters is located at 2000 Ultimate Way, Weston, Florida 33326 and our telephone number is (954) 331-7000.

## **Capabilities of UltiPro**

UltiPro is a comprehensive cloud-based solution designed to deliver the functionality businesses need to manage the complete employee life cycle from recruitment to retirement, and to facilitate employee engagement with their employers and each other. The solution includes feature sets for talent acquisition and onboarding, HR management and compliance, benefits management and online enrollment, payroll, performance management, employee engagement surveying, compensation management, succession management, learning management, reporting and analytical decision-making tools, time and attendance, and role-based self-service capabilities for executives, managers, administrators, and employees whether they are in or out of the office. UltiPro offers the following capabilities to our customers:

*Role-Based Internet Access to Functionality.* UltiPro provides Web access to workforce-related business functions, company communications, and reporting for everyone in our customer's organization, not just the HR department. The access and specific functionality can be tailored to our customer's process requirements and the individual user's role. We believe that UltiPro's employee-facing Web applications can increase management and administrative efficiencies by providing immediate access to reporting, staff management processes and business intelligence for business leaders, and can reduce operating costs

by eliminating the need for organizations to print and distribute paper communications, handbooks, forms, and paychecks. Ultimate also provides UltiPro functionality for use on mobile devices. Using tablets or smartphones, employees can manage their goals, provide feedback to managers, search and apply for career opportunities, access their own personal information, such as pay statements, and view their company's employee directory to look up contact information or employee photos. In addition, managers can approve or deny daily workflow transactions, such as salary changes and paid time off, access reports and analytics, and readily review goals, competencies, and accomplishments of their team members.

*Rich and Highly Configurable Functionality.* UltiPro has rich functionality built into the solution and provides extensive capabilities for configurability. As a result, we have found that our customers can avoid extensive customizations and yet are able to achieve a highly tailored solution to meet their specific business needs. Since UltiPro's feature-sets are unified, our customers are able to streamline their management of the total employment cycle and can generate strategic HR and talent management reports from UltiPro as their primary, central system of record for their employee data.

*Flexible, Rapid System Setup and Configuration.* UltiPro has been designed to minimize the time and effort required to set up and configure the system to address individual company needs. Largely because our UltiPro solutions deliver extensive functionality that can be configured to align with our customers' various business models with few customizations, our setup of new customers is faster and simpler than implementations typical of legacy, on-premise software.

*Reduced Total Cost of Ownership.* We believe that the UltiPro solution provides cost saving opportunities for our customers and that UltiPro is competitively priced. In addition, we believe that our current practices in activating the UltiPro solution result in cost savings for customers when compared with implementations of other similar solutions in the industry. The UltiPro customer may also reduce the administrative and IT support costs associated with the organization's HR, benefits and payroll functions over time. Administrative costs can be further reduced by providing an organization with greater access to information, streamlined HR processes and transactions, and control over reporting.

*Modern Cloud Technologies.* We have consistently focused on identifying leading technologies and practices and integrating them into our products. The primary characteristics of our technology and cloud architecture are:

- Multi-tenant model (multiple instances of UltiPro for different organizations can reside on one server) that allows each application component to run on a separate farm, or cluster, of load-balanced servers while still providing customer data security and segregation.
- Configurability that enables customers to achieve a highly tailored UltiPro experience for their businesses without incurring the high expense of custom software.
- Web services, with a focus on micro-services (a set of platform-neutral and vendor-independent protocols that enable application interactions over the Internet using Extensible Markup Language, or XML, and other Web technologies) that enable UltiPro customers to connect with other applications and data services easily and securely.
- Domain-driven, user-centered design framework that leverages industry-leading tools and technologies, including, but not limited to, Microsoft's .NET platform, Openstack, JavaScript, jQuery, Bootstrap, AngularJS, and Docker to streamline the complexities of our HCM domain and focus on how our users want to use UltiPro rather than expect them to change their behavior to accommodate our product.
- HTML-5 framework and responsive Web design for mobile-centric computing that enables a rich, dynamic user experience for UltiPro users on the smartphones or tablets of their choice.

*Rich End-User Experience, Ease of Use and Navigation.* We design our products to be user-friendly and to simplify the complexities of managing employees and complying with government regulations in the HR, payroll, and talent management areas. UltiPro uses familiar, consumer-style navigation, which we believe makes our solution convenient and easy to use. While traveling or out of the office, our customer's HR professionals, executives, managers, administrators, and employees can manage payroll and employee functions and run reports by accessing UltiPro over the Internet or find answers to key routine questions by using an UltiPro application on their mobile devices.

*Comprehensive Customer Services and Industry-Specific Expertise.* We provide several types of customer service: cloud services, professional setup and activation services, customer support services, knowledge (or training) services, and a group of optional service offerings we call Select Services that includes payment services (such as tax filing, garnishment management and check printing), ongoing managed services, and other specific-need services such as filing the Patient Protection and Affordable Care Act ("ACA") compliance documents for customers. The voice of our customers is incorporated into all of our processes, and all of our services are designed to create a positive, proactive and productive UltiPro experience for our customers. We have multiple avenues for our customers to give us feedback and recommendations on product enhancements, and we provide our customers a portal where they can choose to learn about UltiPro and Ultimate in the style that best suits them - online webinars, videos, instructional documents, online chats, customer communities, and other vehicles.



We recognize the importance of issuing timely updates that reflect changes in tax and other regulatory laws and employ a dedicated research team to track jurisdictional tax changes for more than 10,000 active tax codes included in UltiPro as well as changes in other employee-related regulations.

*Managed Services.* As part of our mission to simplify the work lives of our customers' human resources and payroll people, we introduced UltiPro Managed Services in the fourth quarter of 2013 as a result of our acquisition of certain assets and liabilities of Accel HR, LLC ("Accel HR"). These managed services are now part of our Select Services offerings and are designed for those customers who want to outsource some components of their HR, payroll, benefits, and HCM technology management functions without sacrificing the control of, or access to, their employee data that they enjoy with our cloud solution. Unlike other outsourced payroll or Human Resources Information System ("HRIS") services that typically take a one-size-fits-all approach, our customers can select from a variety of payroll management, HRIS, and/or benefits management services and combine them into a tailored bundle that best suits their unique needs.

### **UltiPro Standard Functionality and Optional Capabilities**

UltiPro's standard functionality includes, but is not limited to, a set of role-based features that engage employees while allowing HR generalists as well as benefits, compensation, and payroll managers and other business managers to develop, coach, evaluate and reward their people and meet organizational objectives. Business intelligence along with system configuration tools and integration capabilities support our customers' connections with third-party applications and providers. UltiPro also includes employee relations tools for managing disciplinary actions and grievances, and health and safety incidents.

In addition to UltiPro's HCM functionality, our customers have the option to purchase a number of additional capabilities on a per-employee-per-month ("PEPM") basis, which are available to enhance and complement the core functionality of UltiPro and which are based on the particular business needs of our customers. These optional UltiPro capabilities currently include (i) the talent acquisition suite (recruitment and onboarding); (ii) the talent management suite (performance management, talent predictors, and succession management); (iii) learning management; (iv) employee engagement surveys; (v) compensation management; (vi) benefits enrollment; (vii) time management; (viii) payment services (formerly referred to as "tax filing"); (ix) wage attachments; and (x) other optional features (collectively, "Optional Capabilities"), which are described below.

Differences between capabilities available to our enterprise, mid-market and strategic customers are specified below. Unless otherwise specified, capabilities are included in both our enterprise and mid-market offerings.

### ***UltiPro's Standard HR/Payroll Functionality***

UltiPro can act as the gateway to business activities for a company's executives, management team, HR/payroll staff, administrators, and employees. Employees of customers can access UltiPro from standard Web browsers such as Microsoft Internet Explorer, Mozilla Firefox and Google Chrome, view information and perform tasks in a language of their individual choice (most commonly English, Spanish, or French), set their personal preferences for the order and placement of home-page content, and set up access to any available page in one click. Ultimate believes that UltiPro allows our customers to improve service to their employees through better communications and to save time because managers and administrators can complete hundreds of common employee-related tasks, including administering benefits, managing staff and accessing reporting and business intelligence in real time, from one central solution. UltiPro also enables companies to provide secure, on-demand access to company and personal information for their employees over the Internet.

*UltiPro's Standard HR/payroll functionality includes, but is not limited to, the following:*

*Human Resources Management.* UltiPro manages all aspects of a person and their employment relationship regardless of where the employee resides. This includes personal details, skills and competencies, international identification documents, employment history, employment contracts (for those employees in countries that require them), performance, job and salary information, career development and preferences, and health and wellness programs. This allows single country or multinational organizations to easily manage and report on worldwide headcounts, and other critical business metrics. In addition, UltiPro facilitates the recording and tracking of key information for government compliance and reporting in the US, Canada and many other countries. This includes the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Health Insurance Portability & Accountability Act (HIPAA), regulations implemented by the Occupational Safety & Health Administration (OSHA), workers' compensation regulations, the Family Medical Leave Act (FMLA), the ACA, and Equal Employment Opportunity (EEO) laws for the United States. UltiPro also enables compliance with HIPAA confidentiality requirements for protecting sensitive data such as employee social security numbers.

*Benefits Management.* UltiPro allows companies to automate the matching of health, welfare, dental, vision, and other benefits they offer their employees, including configuration and administration of benefit plans and employee and employer contributions. UltiPro also enables employees to check benefit options and coverage online. UltiPro eliminates the need for duplicate rules, duplicate data entry, and reconciliation reporting because it stores details for deductions and benefit plans in one common table. These features include rules for coverage, premium and employer match computations, and eligibility and participation determinations. UltiPro also allows companies to maintain and administer paid time off benefits, such as vacation (including calculating benefit accrual amounts), track leave-time taken, and facilitate the response to employee leave requests.

*Payroll.* UltiPro's payroll features a powerful engine that handles hundreds of payroll-related computations intended to minimize the customer's need for side calculations or additional programming. For example, UltiPro delivers complex wage calculations such as average pay rates for overtime calculations, shift premiums, garnishments and levy calculations. With UltiPro, a company's central payroll department, remote offices or multiple divisions can process payroll and can define and report on who completes each specific processing step based on the exact needs of the organization, thus supporting appropriate separation of duties. All of this is managed through an easy-to-use dashboard of payroll tasks and statuses. To help our customers reduce the complexities and errors associated with administrators manually assigning appropriate payroll taxes to employees in the United States, Ultimate offers an embedded feature called Smart Tax Search™. Smart Tax Search™ leverages the latest GIS (geographic information systems) technology to enable UltiPro to automatically assign the correct federal, state, and local payroll taxation rules based upon the home and work addresses listed in UltiPro's employee records.

*Tablet-Based Time clock.* UltiPro TouchBase, which was introduced in connection with our acquisition of Employtouch (the "Employtouch Acquisition"), provides our customers an interactive mobile time clock device that collects time punches, as well as highlights the information most critical to employees and managers via an engaging activity stream. With UltiPro TouchBase, our customers can capture employee time on a touchscreen tablet device, collecting employee-validated data for cost accounting and payroll; can leverage photos for accurate capture of employee time-entry, avoiding 'buddy punches'; and can validate transactions using PIN (Personal Identification Number) entry, HID (Human Interface Device), RFID (Radio Frequency Identification), magnetic swipe or barcode.

*Role-Based Self-Service.* Authorized managers have self-service access to staff information such as salary, compensation history, key dates and emergency contacts, with reporting and workforce analysis tools to facilitate decision-making. A customer's managers can view and update staff information, manage department activities, post job openings, leverage recruiting and hiring tools, and perform queries on workforce data. UltiPro's document management features can be used to house and categorize employee-related documents such as drivers' licenses, consent forms, and completed I-9 forms with required identification. Administrators, managers and employees have the ability to attach files in standard formats such as Microsoft Word, PDF, JPEG, and spreadsheets to employee files. The documents can be grouped and sorted to individual requirements, as necessary.

Employees also may be given immediate, security-protected access to view their own pay details on a mobile device or the Web, and benefits summaries, frequently used forms, and company information on the Web. They can also update personal information such as address, phone number, emergency contacts, and skills; change their preferences such as direct deposit accounts and benefits selections; make routine requests such as asking for vacation time; and enroll in training.

*UltiPro Business Intelligence.* UltiPro Business Intelligence uses a business intelligence platform from IBM Cognos Corporation, a third-party provider, for HR, payroll, and talent management reporting and analysis. Accessed via the Web, UltiPro Business Intelligence gives users the ability to access data across the UltiPro solution - from HR, payroll to benefits administration and enrollment, compensation, talent acquisition and onboarding, talent management, compensation, compliance, year-end data, and more - and enables them to create, modify, and distribute workforce-related reports and notifications. UltiPro includes a pre-configured data mapping library and pre-authored reports and analytics. Controlled by role-based security, everyone in a customer's organization—from line managers to executives can have immediate access to key workforce metrics, and they can personalize their own user experience to show the reports they want to see and how they want to see them. We believe that UltiPro Business Intelligence gives our customers significant strategic value for managing their workforce-related functions and saves them labor time and money by eliminating or reducing the need for internal technology people to generate hundreds of individual reports for disparate executive and management needs. UltiPro Business Intelligence is available to manager roles on a mobile device or tablet via UltiPro Mobile to provide quick access to mobile optimized reports and analytics. We also embed key data visualizations in context of the application. These data visualizations are developed as part of the core application and provide in-context support to decision-makers.

*Other Key Capabilities.* UltiPro's tracking of hours worked in payroll ties to UltiPro's benefits management, enabling automatic calculation of employees' hours of service eligibility and providing HR leaders analytical insight into compliance risk related to the ACA delivered in the Healthcare Eligibility Dashboard and via our UltiPro ACA Toolkit. UltiPro includes system configuration tools such as graphical workflow configuration and platform configuration to allow customers to extend UltiPro

with new secure, reportable fields. In addition, UltiPro offers role-based security, flexible business rules, and an easy-to-use content management tool. Conditional workflow enables organizations to authorize HR/payroll staff, managers, or supervisors to manage key HR processes via UltiPro, expediting business activities such as hiring an employee or making a salary increase. UltiPro workflow is configurable based on customer need and includes numerous pre-configured processes based on industry best-practices. System administration is designed to enable non-technical users to administer UltiPro's role-based security, built-in conditional workflow, and system business rules, as well as to enable system administrators to post company communications, link to external Web sites and tailor functionality to reflect the customer's own company user experience requirements. Enterprise Integration Tools also are included to provide the ability to interface with third-party cloud and on-premise applications and providers such as general ledger, payment services, time clocks, banks, 401(k) and benefits providers, check printing services and unemployment management services.

*UltiPro Predictors.* The UltiPro predictive analytics solution is a key part of the core UltiPro suite where predictive metrics and indicators are available to support manager decisions. The predictors are based on statistical algorithms we developed over the course of more than two years and validated with numerous customers. UltiPro's predictive metrics help managers to determine the best actions to take for further developing or changing the career trajectory of employees reporting to them, thereby helping organizations to reduce turnover and improve employee engagement. For example, organizations can set tolerances for certain predictive metrics in our UltiPro Retention Predictor™, giving a manager or HR generalist the ability to see immediately if an employee exceeds the tolerance level they have defined as "risk of leaving" and, thereby, providing them an early warning to take an appropriate action to increase the chances of that employee staying. In addition to our UltiPro Retention Predictor, the solution includes an UltiPro High Performer Indicator™, which identifies employees who consistently receive high pay raises, and an UltiPro High Performer Predictor™, which ranks employees predicted to be high performers based upon a number of variables tracked in UltiPro, and the UltiPro Engagement Indicator which provides insight into an employee's level of engagement at their organization. To assist managers in creating actions to increase the engagement and retention of team members, UltiPro includes a section called Leadership Actions, based on best practices in talent management, to serve as optional methods for following up.

### ***UltiPro's Optional Capabilities***

*UltiPro Talent Acquisition* is a suite of add-on products comprised of Recruitment and Onboarding.

*i) Recruiting.* The Ultimate team designed our recruiting solution to transform the recruiting process by increasing candidate engagement and simplifying the work of recruiters. Built to be candidate-centric, UltiPro Recruiting has a consumer-like interface to attract and keep top talent engaged, with the goal to reduce the typical 40 percent to 80 percent online application drop-off rate typically occurring with traditional applicant tracking solutions. Rather than being restricted to limited profile information and résumés typical of traditional solutions, candidates can build an in-depth online presence that gives recruiters and hiring managers a more complete understanding of who they are. UltiPro Recruiting includes an appealing user interface, gamification, and collaboration tools. It is fully mobile and integrates with popular social networks such as LinkedIn and Twitter. At the same time, UltiPro Recruiting automates the recruiting process for hiring managers, recruiters, and HR staff by enabling them to track and manage standard recruitment tasks such as posting open jobs, reviewing résumés, screening candidates, and scheduling interviews.

*ii) Onboarding.* UltiPro Onboarding is a comprehensive solution that provides employers the ability to engage and welcome new employees into an organization before the first day of work and to speed their time to productivity. UltiPro Onboarding enables dynamic content such as video messages from executives, managers, and co-workers and gives new hires the ability to connect with fellow team members, request a mentor, engage in self-directed learning through a feature called 'Unlock Your Potential,' and complete compliance and other required documents. The solution is easily configurable to meet the specific needs of an organization and includes such activities as obtaining required government and procedural paperwork, including electronic signatures and document storage; provisioning necessary equipment and job-specific tools such as office location, computer equipment, and uniforms; ensuring enrollment in necessary training programs; and instilling the employer's core values and business objectives.

*UltiPro Talent Management* is a suite of add-on products comprised of Performance Management, Talent Predictors, and Succession Management.

*i) Performance Management.* UltiPro Performance Management helps companies maximize the development of their people and improve employee satisfaction by automating and enhancing the performance process, using competency-based employee development. UltiPro Performance Management streamlines the processes of evaluating performance and completing performance reviews, making competency assessments, identifying top performers for

succession planning, and tracking and executing coaching, training and development plans. The solution also supports a continuous process of capturing real-time employee feedback from a social network and, through our mobile solution, makes goal management, talent profile information, employee observations, and goal journaling convenient for employees.

ii) *Succession Management.* With UltiPro Succession Management, organizations can involve company leadership, managers, and individuals in an ongoing, collaborative process of succession planning. Employees can manage their own talent profiles-updating factors that influence succession readiness such as mobility preferences, languages, education, accomplishments, and competencies-to ensure that leadership has a deeper understanding of the talent landscape at their organization. Visible to employees and managers, UltiPro's employee "talent card" provides a consolidated and comparative view of multiple succession-readiness factors, which then can be used in both decision-making and career development processes.

*Other Optional Capabilities* include, but are not limited to, the following products, which are supplemental to UltiPro's standard HR/payroll capabilities:

*UltiPro Learning.* Through a strategic partnership, Ultimate has the right to market and distribute an independent third party's learning management product as part of the UltiPro solution. We have branded this product UltiPro Learning. Ultimate is the single-source contact for customer implementations and ongoing solution support for UltiPro Learning. It is both Web-based and mobile and is integrated with UltiPro's HR and talent management functionality. UltiPro Learning is a new approach to learning that supports the collaborative and on-demand nature of learning demanded by employees today. UltiPro Learning allows organizations to create, curate, and deliver learning content to employees to meet their professional and personal learning needs. Customers can also create learning academies to meet specific organizational needs.

*UltiPro Perception.* UltiPro Perception was introduced as part of the acquisition made in the third quarter of 2016 of Kanjoya, Inc. ("Kanjoya"), a California corporation (the "Kanjoya Acquisition"), located in San Francisco, California. UltiPro Perception offers a modern way to collect and understand feedback through employee surveys and in-depth analytics of that data for HR and managers. The solution enables organizations to solicit feedback from employees in both structured and unstructured forms. Using the power of the ingrained Natural Language Processing (NLP) engine, UltiPro Perception analyzes feedback in a variety of ways, providing leaders a deeper understanding of employee sentiment while safeguarding employee privacy and anonymity. The built-in analytics allow everyone from HR and company executives to individual managers to view and gain a deeper insight into employee sentiments, identify employee feedback trends, and compare team results. These insights provide the basis for organizations to take appropriate action tailored to the needs of both teams and leaders, with the objective to improve engagement, satisfaction, and retention.

*Compensation Management.* UltiPro Compensation Management includes Salary Planning, Salary Budgeting and Incentive Compensation Plans capabilities. This expanded solution is designed to support executives, managers and compensation analysts working with salary increase allocations and to incentivize employees by giving them visibility into their individual compensation plans. Highly configurable, including multi-currency and pro-rata capabilities, UltiPro Compensation Management makes it easy for companies to manage their unique compensation plans and salary award processes with flat amounts, percentages and unit-based compensation such as restricted stock unit awards. Managers can review their salary budgets and merit pool guidelines and determine the best way to allocate pay increases to their employees within their approved budget parameters. Once managers decide on the allocations, they submit pay increases through UltiPro Payroll.

*Benefits Enrollment.* With UltiPro Benefits Enrollment, employees can enroll in the appropriate benefit plans for their individual needs online, either at work or from home, during defined open enrollment periods. Employees can also choose to quickly renew their benefits in a single click and are guided to make the right selections based on prerequisites that link benefit plans together. UltiPro mobile capabilities enable employees to update their retirement contributions on the go. Benefits administrators can configure the enrollment process and messaging to make the process easy for employees and can monitor the enrollment progress. UltiPro Benefits Enrollment also guides employees through the benefit and personal information changes necessary as a result of life events such as getting married, having a baby or moving. UltiPro also delivers more than 70 predefined Benefit Carrier templates to facilitate the electronic feeds required for insurance carriers and plan administrators, reducing the need for manual reporting of employee census information, participant coverage, and billing reconciliation.

*Time, Attendance, and Scheduling (designed for enterprise companies).* Through a strategic partnership, we have the right to market and distribute an independent third party's time and labor management product as part of the UltiPro solution. We have branded this product as UltiPro Time and Attendance, marketing the components as UltiPro Time and Attendance, UltiPro Leave Management, and UltiPro Workforce Scheduling (collectively, "UTA"). Ultimate is the single-source contact for customer implementations and ongoing solution support for UTA. UTA is Web-based and integrated with UltiPro's payroll, HR,

and benefits functionality. UltiPro Time and Attendance tracks time and attendance labor metrics and supports a variety of time-capture mechanisms. UltiPro Leave Management includes all of the functionality required to effectively track and manage employee leave. UltiPro Workforce Scheduling features industry-specific employee scheduling options to ensure that organizations in different environments deploy employees in an efficient and legislatively compliant manner.

*Time Management (designed for mid-market and strategic companies).* UltiPro Time Management delivers the functionality and flexibility needed to manage employee time and attendance efficiently and provides Web access to real-time employee time and labor information. UltiPro Time Management provides companies with the tools to proactively prevent issues that negatively impact business performance, such as employee coverage gaps, labor law violations, and excess labor spending. Fully integrated scheduling, time and attendance, and leave management capabilities reduce payroll expenditures and streamline payroll and workforce management processes.

*Payment Services.* We have the right to market and distribute an independent third party's tax filing solution that we have branded UltiPro Payment Services ("UltiPro Payment Services"). With this solution, companies are able to meet all Federal, state, and local payroll tax filing obligations quickly and easily. The UltiPro solution saves payroll staff time by eliminating the administrative burdens associated with tax filing. UltiPro Payment Services enables businesses to deposit federal, state, and local tax payments for more than 10,000 active tax codes via electronic funds transfer or check and automates filing for monthly, quarterly, and annual tax returns.

*Wage Attachments.* For organizations required to process third-party payments on behalf of their employees for items such as child support, tax levies, and creditor garnishments, UltiPro Wage Attachments provides the means to effectively streamline and manage the payment process. UltiPro Wage Attachments eliminates the burden associated with payments to third parties by using information entered and calculated in UltiPro, so there is no need to manage payment processing or analyze varying disbursement schedules for multiple jurisdictions. We ensure that each third-party payment is made according to the designated payment method and reaches its required destination within the assigned timeframe.

*Patient Protection and Affordable Care Act (ACA) Compliance.* In the fall of 2015, Ultimate began deploying an ACA Toolkit that enables our customers to comply with ACA regulations by the 2016 deadline. The toolkit is embedded in UltiPro and automatically populates the Forms 1094-C and 1095-C with the appropriate information. In addition, Ultimate offers our customers additional optional ACA-related services branded UltiPro ACA Employer Services. These include such services as printing and electronic filing of 1094-C and 1095-C forms with the IRS on our customer's behalf and ongoing proactive monitoring and managing of employee eligibility alerts, notices, and penalty responses.

*Other Optional Capabilities.* We offer a number of additional HR and payroll-related services to extend the value of UltiPro, including test environment services, W-2 print services, pre-employment screening, paycheck modeling, pay cards, unemployment tax management, employment verification services, employee assistance, health and wellness, and work/life balance programs. In addition, we offer UltiPro Federated Single Sign-On for standards-based identity management by leveraging Microsoft's Active Directory Federated Services infrastructure as well as single-sign-on capabilities through our partner Ping Identity. These solutions help improve and simplify data security by enabling individuals to use a single login credential (such as a network login) to seamlessly access UltiPro over the Internet.

## **Technology**

We strive to use the most modern and capable technologies available for delivering solutions that are flexible, easy to use, fast, and secure. Major characteristics of our cloud application platform include, but are not limited to, the following:

*Multi-tenancy.* As a SaaS provider, we use a multi-tenant cloud model that allows us to support multiple customers on a single set of systems while maintaining performance, security, and reliability. We manage and maintain our solutions for our customers, including all hardware and software upgrades. Our customers benefit by reducing their need to keep their own IT resources on staff for UltiPro solutions. Our cloud customers also benefit from having the most current version of UltiPro installed as soon as it is available.

*Configurability.* We have invested in our own technology and approaches for enabling application and system configurability, giving our customers the ability to achieve a highly tailored solution while minimizing or eliminating the need to create custom code.

*Openness and Connectivity.* We leverage widely adopted technology and industry standards for exposing data and functionality via application programming interfaces (APIs). Customers can access their HCM data based on these standard, open, and secured connections in order to link to their in-house systems, third-party cloud applications, and other systems that require data feeds such as benefits providers. Our UltiPro Carrier Network (UCN) leverages industry-leading solutions from Informatica, allowing Ultimate to create standard, reusable connectors that support the unique data transfer requirements of

individual benefits providers, simplifying both the development and maintenance of these connections. Ultimate also supports a number of pre-packaged connectors for solutions that expand or extend the functionality included in UltiPro. These packaged integrations include, but are not limited to: Yammer, a provider of enterprise social networking solutions; CERTPOINT, a provider of learning management solutions; and Ping Identity, which offers single-sign-on capabilities for business applications.

*Domain-Driven, User-Centered Design.* Our solution design approach includes domain-driven design, which provides a streamlined process for developing software with the complexities of an HCM domain in alignment with the principles of a service-oriented architecture (SOA). A key focus of our user-centered design is to optimize the overall user experience of our customers and to maximize user engagement. We have invested significant resources in usability design and testing to create a consumer-grade experience that is flexible, responsive, and personalized. In the design of the user-experience, our emphasis is on how users want to use the product rather than the expectation that users will change their behavior to accommodate the product.

*Mobile-Centric User Experience.* In addition to the user experience capabilities available through Microsoft.NET, Ultimate uses Hypertext Markup Language version 5 (HTML5) and responsive Web design approaches to deliver flexible user experiences for smartphones and tablets. This mobile framework supports applications delivered through multiple browsers and automatically adapts to screen size and orientation and takes advantage of gesture-based capabilities. Other features of our mobile-centric user experience include search for both people data and functionality, configurability for individual users that allows them to drag and drop individual content 'gadgets' and menu controls, and favorite-specific functionality for quick access.

*Workflow.* Ultimate supports numerous transactions and operational processes for our customers. These processes are frequently unique to an individual customer and typically require multiple steps, approvals, data input, and confirmations. To support our customers' unique requirements, UltiPro includes configurable business process automation, or workflow, which enables customers to automate processes based on their own needs and change these processes over time without custom software code.

*Business Intelligence.* Ultimate provides sophisticated data query and report authoring via IBM Cognos, a leading suite of business intelligence tools. Our customers can access reports and conduct data queries from a Web browser and are able to apply on-line analytical processing to multidimensional data cubes for exploring data on employees graphically and statistically from diverse angles. We maintain a link between Cognos' report catalog and UltiPro's data dictionary, eliminating the necessity for customers to create and maintain ad hoc reporting catalogs on their own. We also maintain a BI Exchange, an online community where Ultimate professionals and customers can post, download, and share standard reports. We have unified security for the data elements across UltiPro and Cognos instances so that role-based security controls data access across both solutions. We also provide single sign-on to simplify and secure user access.

## **Data Centers for Cloud Offering**

Our cloud offering provides Web-based access to comprehensive HCM functionality for organizations that want to simplify delivery and support of their business applications. As a part of our cloud offering services, Ultimate provides the hardware, infrastructure, ongoing maintenance and backup services for our customers at four data centers. The data center located near Atlanta, Georgia, is owned and operated by Quality Technology Services ("QTS"). The data centers located near Toronto and Vancouver, Canada, are owned and operated by CenturyLink Technology Services ("CenturyLink") (formerly known as Savvis Communications Canada, Inc.), and the data center located in Phoenix, Arizona, is owned and operated by IO Phoenix One, LLC.

Ultimate's use of the data center located near Atlanta, Georgia, is governed by a Master Space Agreement dated February 2, 2012 with Quality Technology Services Metro, LLC ("QTS Metro"). Pursuant to the terms of the QTS Agreement, Ultimate may from time to time submit orders for the use of certain physical space within the data centers for hosting Ultimate's hardware equipment, as well as Internet connectivity services, security, power and generator back-up, environmental controls and access controls. The QTS Agreement provides that any service order will automatically renew for successive renewal terms, unless either party notifies the other party in writing at least sixty days prior to the end of the then current term that there will be no such renewal. Furthermore, the QTS Agreement may be terminated at any time by either party thereto, if: (i) the non-terminating party breaches any material term of such QTS Agreement and fails to cure such breach within 10 days after receipt of written notice; (ii) the non-terminating party becomes the subject of a voluntary or involuntary proceeding relating to insolvency, bankruptcy, receivership, liquidation, or reorganization; or (iii) a court or other government authority having jurisdiction over the services prohibits the furnishing of services governed by such QTS Agreement.

Ultimate's use of the data centers located near Toronto and Vancouver, Canada, are governed by a Master Services Agreement dated April 30, 2013 (the "CenturyLink Agreement") between Ultimate's wholly owned subsidiary Ultimate Canada and CenturyLink. Pursuant to the terms of the CenturyLink Agreement, Ultimate Canada has use of certain physical space

within the data center for hosting Ultimate Canada's hardware equipment, as well as Internet connectivity services. The CenturyLink Agreement contains provisions relating to data security and access to the data center. Upon placing a service order, Ultimate Canada is guaranteed certain pricing terms and is committed to minimum usage levels for a period of at least 36 months from the effective date of April 1, 2016, per an addendum entered into by both parties to extend the term of the original agreement. The CenturyLink Agreement will renew on a month-to-month basis unless either party gives at least sixty days written notice prior to the completion of the applicable term that there will be no such renewal. The CenturyLink Agreement provides that its term will end upon the expiration of the term of the last-executed service order. Ultimate has guaranteed the payment of all amounts due from Ultimate Canada to CenturyLink under the CenturyLink Agreement.

Ultimate's use of the data center located near Phoenix, Arizona is governed by a License and Master Services Agreement dated February 27, 2012 (the "IO Phoenix Agreement") with IO Phoenix One, LLC. Pursuant to the terms of the IO Phoenix Agreement, Ultimate has use of certain physical space within the data center for hosting Ultimate's hardware equipment, as well as Internet connectivity services. The IO Phoenix Agreement contains provisions relating to data security and access to the data center. Ultimate is guaranteed certain pricing terms and is committed to minimum usage levels for a period of at least 42 months from November 1, 2014, the effective date of an addendum entered into by both parties to extend the term of the original agreement. The IO Phoenix Agreement will automatically renew thereafter for additional terms of one year unless either party gives written notice prior to the completion of the applicable term that there will be no such renewal. Ultimate must give written notice within 60 days while IO Phoenix must give written notice within 120 days.

## **Pricing**

Our cloud offering is designed to provide an appealing pricing structure to organizations that prefer to minimize the initial cash outlay associated with typical capital expenditures for traditional on-premise products. Our cloud customers purchase the right to use UltiPro on an ongoing basis for a specific term in a shared or dedicated hosted environment, and the arrangement can typically be renewed after its initial term has expired. In the shared environment, Ultimate provides an infrastructure with servers shared among many customers who use a Web browser to access the application software through the related data center. In the dedicated environment, the customer does not share servers with other customers but rather has its own set of servers. The pricing for our cloud offering, including both the hosting element as well as the right to use UltiPro, is on a per employee per month ("PEPM") basis.

## **Research and Development Activities**

Ultimate incurs research and development expenses, consisting primarily of software development personnel costs, in the normal course of our business. Such research and development expenses are for enhancements to our existing products and for the development of new products. During 2016, 2015 and 2014, we spent \$158.5 million, \$120.0 million and \$108.8 million, respectively, on research and development activities, gross of capitalized software. During 2016, 2015 and 2014, \$37.9 million, \$26.3 million and \$25.2 million, respectively, of research and development expenses were capitalized for computer software development costs related to an internal-use development project that is expected to be offered in the future. UltiPro Recruiting, a component of the overall capitalized development project, became ready for its intended use during May 2014. UltiPro OnBoarding, another component of the overall capitalized development project, became ready for its intended use during December 2016. Amortization for the components of the development project that are completed will begin when they are ready for their intended use and will be included with cost of recurring revenues in our statement of operations once amortization commences.

## **Customer Services**

Network Products Guide named Ultimate's services team the "Best Customer Service Department of the Year" in its 2016 IT World Awards, and the Technology Services Industry Association recognized our services team for "Innovation in Transformation of Support Services" in its 2016 TSIA Star Awards. In addition, G2 Crowd recognized Ultimate as #1 in Customer Satisfaction for HR Management Suites in 2016, and we believe this rating is a result of both our services and product teams' work. G2 Crowd is an online business software review platform that bases its rankings on user reviews of solutions.

We believe that our focus on delivering our customers a positive and productive UltiPro experience has differentiated Ultimate in the marketplace and is critical to the quality of Ultimate's comprehensive service solution. We provide our customer services in two broad categories: (i) professional services and (ii) customer support services and product maintenance. Additionally, we provide services associated with the delivery of our cloud-based solutions. These services include, but are not limited to, purchasing and supporting hardware and system software; installing new versions of UltiPro; and backing up customer data.

*Professional Services.* Ultimate's professional services include system setup and activation (i.e., implementation), executive relationship management ("ERM"), and knowledge management (or training) services. We believe that our setup and activation consulting services are differentiated from those of other vendors by speed, predictability and completeness. Our successful record with rapid system activation and implementations is due, we believe, to our standardized methodology, consultants, highly configurable product functionality, and comprehensive conversion and integration tools.

Ultimate has a primarily long-tenured team of functional and technical consultants who are dedicated to assisting customers with rapid deployments. In addition, we provide our customers with the opportunity to participate in formal training programs conducted by our knowledge management services team, as well as online scheduled courses and on-demand training. Training programs are designed to increase our customers' ability to use the full functionality of our products, thereby maximizing the value of our customers' investments. Courses are designed to align with the stages of implementation and to give attendees hands-on experience with UltiPro. Trainees learn such basics as how to enter new employee information, set up benefit plans and generate standard reports, as well as more complex processes such as defining company rules, configuring the system and creating custom reports. Ultimate maintains training facilities in Atlanta, Georgia; Schaumburg, Illinois; Dallas, Texas; Santa Ana, California; and at our headquarters in Weston, Florida. Ultimate rents training facilities in other locations, such as Toronto, Canada, on an as-needed basis. In addition to offering classes at these facilities, we conduct Web-based training, and provide recorded on-demand training as well as "Quick Tours" for rapid assistance in specific areas of the solution. After our customers have processed their first live payroll using UltiPro (referred to as going "Live") and have been turned over to our customer support and maintenance program, we assign a customer relationship manager to the account to assist customers obtaining maximum value of the UltiPro solution, connect with other Ultimate users and advanced business analytics. The ERM team also focuses a large portion of its time on customer retention, which is an important aspect of Ultimate's long-term business model.

*Customer Support.* We offer comprehensive and on-going support services to all of our UltiPro customers. Ultimate had a recurring revenue cloud customer retention rate which was approximately 97% in 2016. Ultimate's customer support services include: software updates that reflect tax and other legislative changes; a named customer service representative; telephone support 24 hours a day, 7 days a week; unlimited access to Ultimate's employee tax center on the Web; seminars on year-end closing procedures; a customer blog; and periodic newswire emails. In addition, our customer support services team maintains a Customer Success Portal for our customers where customers can submit inquiries and service requests as well as search a knowledge base of information for instant answers to questions, holds an annual national user conference and arranges for Ultimate professionals to attend smaller, user-organized user group meetings on a routine basis throughout the United States.

## **Customers**

As of December 31, 2016, Ultimate provides our UltiPro solutions to approximately 3,700 customers with approximately 33 million people records in our cloud. Ultimate's customers represent a wide variety of industries, including manufacturing, food services, sports, technology, finance, insurance, retail, real estate, transportation, communications, healthcare and other services. For each of the three years ended December 31, 2016, no customer accounted for more than 10% of total revenues.

## **Sales and Marketing**

We market and sell our products and services primarily through our direct sales force.

Our direct sales force includes business development vice presidents, directors and managers who have defined territories, typically geographic. The sales cycle begins with a sales lead generated through a national, corporate marketing campaign or a territory-based activity. In one or more on-site visits, phone-based sales calls, or Web demonstrations, sales managers work with application and technical sales consultants to analyze prospective client needs, demonstrate Ultimate's UltiPro solutions and, when required, respond to requests for proposals. The sale is finalized after customers complete their internal sign-off procedures and the terms of the contract are negotiated and signed.

With a sale of the cloud offering, the agreement generally requires PEPM fees based on company size, and bundled fees for implementation and training. Typical payment terms include a deposit at the time the contract is signed and ongoing PEPM payments on specific payment dates designated in the contract, usually tied to the Live date.

We support our sales force with a comprehensive marketing program that includes public relations, advertising, direct mail, trade shows, seminars and workshops, email marketing, social media marketing, and Web marketing. Working closely with the direct sales force, customers and strategic partners, our marketing team defines positioning strategies and develops a well-defined plan for implementing these strategies. Our marketing services include market surveys and research, overall



campaign management, creative development, demand generation, results analysis, and communications with field offices, customers, and marketing partners.

### **Intellectual Property Rights**

Ultimate's success is dependent, in part, on our ability to protect our proprietary technology. We rely on a combination of copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We do not have any patents or patent applications pending.

### **Competition**

The market for our products is highly competitive. Our products compete primarily on the basis of technology, delivered functionality, price/performance and service.

Ultimate's competitors in our enterprise market include (i) large service bureaus, primarily Automatic Data Processing Inc. ("ADP") and, to a lesser extent, Ceridian; and (ii) companies, such as Oracle, Lawson, and Workday that offer human resource management and payroll software products for use on mainframes, client/server environments and/or Web servers. In our mid-market and strategic market, Ultimate's competitors include payroll service providers, such as ADP, Ceridian and Paychex.

### **Backlog**

Backlog consists of our UltiPro cloud-based solutions under signed contracts for which the services have not yet been delivered. Our backlog amounts include the full contract value of sales to our customers that have not yet processed their first payroll using UltiPro and are not indicative of the annual recurring revenue value of such sales. Backlog can vary from one year to the next when the average contract period fluctuates significantly. At December 31, 2016, Ultimate had backlog of \$399.9 million compared with \$320.1 million as of December 31, 2015. Ultimate expects to fill approximately \$349.6 million of the backlog during 2017. Ultimate does not believe that backlog is a meaningful indicator of sales that can be expected for any future period. There can be no assurance that backlog at any point in time will translate into revenue in any subsequent period.

### **Employees**

As of December 31, 2016, Ultimate employed 3,747 people. Ultimate believes that our leadership's relationships with employees are good, and that belief is validated by Ultimate's # 1 ranking on Fortune's 2016 list of "10 Best Large Workplaces in Technology", #15 on Fortune's 2016 "100 Best Companies to Work For" list and #5 on Fortune's 2016 "100 Best Workplaces for Millennials." Also in 2016, Fortune ranked Ultimate # 4 on its list of 100 Best Workplaces for Women and # 5 on its list of 50 Best Workplaces for Diversity. All of these Fortune rankings are determined largely by scores on anonymous employee surveys administered by the Great Place to Work Institute. As reported by Bloomberg.com in November 2015, from a universe of approximately 445,000 companies evaluated, Ultimate received the highest positive-performance outlook from its employees on Glassdoor, exceeding 90%, more than double the Glassdoor company-average of 43%. Ultimate's consistent history of good employee relationships is further validated by Ultimate's #20 ranking on Fortune's 2014 "100 Best Companies to Work For" list, # 9 ranking on its 2013 list, # 25 ranking on its 2012 list, and the Great Place to Work Institute's ranking of Ultimate as the #1 Best Place to Work in America among medium-sized companies for both 2009 and 2008. However, competition for qualified employees in the technology sector and Ultimate's industry is intense. Management of Ultimate believes that our future success will depend, in part, on our continued ability to attract, hire and retain qualified personnel.

### **Available Information**

Ultimate's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and amendments to those reports and any registration statements, including but not limited to registration statements on Form S-3, are available free of charge on Ultimate's website at [www.ultimatesoftware.com](http://www.ultimatesoftware.com) as soon as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission ("SEC"). Information contained on or accessible through Ultimate's website is not part of this Form 10-K. You may record and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains the reports, proxy and information statements and other information regarding us that we file with the SEC. You can access the SEC's website at [www.sec.gov](http://www.sec.gov).

## Item 1A. Risk Factors

Ultimate operates in a rapidly changing and dynamic business environment that involves risk and uncertainty. The following discussion is a description of risks and uncertainties associated with our business that could cause, or contribute to causing, actual results to differ materially from expectations. These are not all of the risks we face. We may be adversely affected by risks not currently known or that we currently consider immaterial.

### ***We may be adversely affected by substantial quarterly fluctuations in our revenues and operating results.***

Our quarterly revenues and operating results have varied significantly in the past and are likely to vary substantially from quarter to quarter in the future. Our quarterly operating results may fluctuate as a result of a number of factors, including:

- Increased expenses from one quarter to another (especially as they relate to product development and sales and marketing);
- Spending patterns of our customers;
- Timing of our product releases;
- Increased competition;
- A drop in the near-term demand for our products, particularly in relation to professional services; and
- Announcements of new products by Ultimate or by our competitors.

We establish our expenditure levels based upon our expectations as to future revenues, which are comprised primarily of recurring revenues and services revenues. If revenue levels are below expectations, particularly services revenues which are more subject to variations between periods than recurring revenues, expenses can be disproportionately high in a particular period. For example, while sales production could be at our level of expectations, depending on the spending patterns of our customers including the timing in which they begin the implementation of UltiPro and the extent to which they use Ultimate's resources, the immediate reported total revenues could be lower than expected.

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

### ***Due to the method of accounting for sales from our cloud offering, a change in the period of the time from contract date to the Live date ("Time to Live") could negatively impact the amount of recurring revenues recognized in a reporting period.***

Sales production, as it pertains to sales of cloud units, is not reflected in recurring revenues and related variable costs in our consolidated statements of operations typically until the related customer goes Live. In our internal business model, we make certain assumptions, among other things, with respect to future sales production, revenue growth, variable costs, personnel costs and other operating expenses.

Our expectations for recurring revenue growth are typically established based on combinations of actual sales production (for those units that have been previously sold but have not yet gone Live) and expected future sales production, together with expectations as to the Time to Live periods. Estimates for Time to Live periods are usually based on (i) specific estimates (for certain backlog sales) provided by our field personnel, which estimates include factors and assumptions that are not within the control of our field personnel; and (ii) estimates for Time to Live periods for other cloud sales (including backlog sales without specific estimates at that point in time), as well as expected sales, which are typically based on assumptions derived from our historical Time to Live periods. These estimates are adjusted periodically, and prospectively, based on management's assessment of Time to Live for backlog sales at that point in time. Factors that could impact the estimates for Time to Live periods include, but are not limited to, customer size (as larger customers may have longer implementations, tend to go Live on more UltiPro features and have more interface and integration requirements), and the number of complementary products sold in addition to UltiPro to a single customer, which in some cases involve customers' desire to go Live on all products at once, as compared with UltiPro first followed by complementary products.

To the extent there are changes in the underlying assumptions which drive Ultimate's expected revenue growth from cloud sales, which include, but are not limited to, actual sales production achieved and changes in Time to Live periods, our recurring revenues, as reported in our consolidated statements of operations, could differ materially from levels we expected to achieve.

### ***A systems failure or other service interruption at the data center owned and managed by QTS, the data centers owned and managed by CenturyLink (formerly known as Savvis), and the data center owned and managed by IO Phoenix One, LLC***

***and used for our hosting services could result in substantial expense to us, loss of customers and claims by our customers for damages caused by any losses they incur.***

We offer hosting services, which include hardware, infrastructure, ongoing maintenance and back-up services, to our customers in the United States at a data center owned and operated by QTS, at a location near Atlanta, Georgia and at a data center owned and operated by IO Phoenix One, LLC near Phoenix, Arizona. We also offer hosting services, which include hardware, infrastructure, ongoing maintenance and back-up services, to our customers with employees exclusively in Canada at two data centers owned and operated by CenturyLink (formerly known as Savvis), one near Toronto, Canada and one near Vancouver, Canada

These hosting services, which are provided as part of our cloud offering, must be able to be reliably operated on a 24 hours per day, seven days per week basis without interruption or data loss. The success of the cloud offering depends on our ability to protect the infrastructure, equipment and customer data files against damage from:

- Human error;
- Natural disasters;
- Power loss or telecommunication failures;
- Sabotage or other intentional acts of vandalism; and
- Unforeseen interruption or damages experienced in moving hardware to a new location.

We perform a daily backup of our customer data which is stored offsite of the data centers. In addition, QTS has implemented various activities comprising QualityTech's Business Continuity Planning & Disaster Recovery Program which includes risk assessment and business impact analysis, redundancy and crisis and emergency response procedures. CenturyLink also has a Business Continuity Program which handles business continuity planning, incident management and site emergency action planning. However, the occurrence of one of the above listed events or other unanticipated problems at any of the data centers could:

- Result in interruptions in the services we provide to our customers, during which time our customers may be unable to retrieve their data;
- Require us to spend substantial amounts of money replacing existing equipment and/or purchasing services from an alternative data center;
- Cause existing customers to cancel their contracts;
- Cause our customers to seek damages for losses incurred; or
- Make it more difficult for us to attract new customers.

***Rapid technological changes and the introduction of new products and enhancements by new or existing competitors could undermine our current market position.***

The market for our products is characterized by rapid technological advancements, changes in customer requirements, frequent new product introductions and enhancements and changing industry standards. The life cycles of our products are difficult to estimate. Rapid technological changes and the introduction of new products and enhancements by new or existing competitors could undermine our current market position. Our growth and future success will depend, in part, upon our ability to:

- Enhance our current products and introduce new products in order to keep pace with products offered by our competitors;
- Adapt to technological advancements and changing industry standards; and
- Expand the functionality of our products to address the increasingly sophisticated requirements of our customers.

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

***If we are unable to enhance our products and develop new services, our revenue growth may be harmed.***

Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing UltiPro standard/HR payroll product and Optional Capabilities and to introduce new features and Optional Capabilities to our product offering. The success of any enhancement or new feature depends on

several factors, including the timely completion, introduction and market acceptance of the enhancement or service. If we are unable to develop enhancements and introduce new features and Optional Capabilities to our existing products in a cost-effective manner that keeps pace with rapid technological developments, our business could be adversely affected. If we are unable to successfully develop, acquire new services or enhance our existing products to meet customer requirements, our revenues may not grow as expected.

***Our stock price has experienced high volatility, may continue to be volatile and may decline.***

The trading price of our Common Stock has fluctuated widely in the past and may do so in the future, as a result of a number of factors, many of which are outside our control, such as:

- The volatility inherent in stock prices within the sector in which we conduct business;
- The volume of trading in our Common Stock, including sales upon exercise of outstanding stock options and upon the vesting of restricted stock and restricted stock units;
- Failure to achieve earnings expectations;
- Changes in our earnings estimates by analysts;
- Variations in our actual and anticipated operating results, including, but not limited to, prospective financial guidance provided by Ultimate to our investors and research analysts; and
- The announcement of a merger or acquisition.

Stock markets have experienced extreme price and volume fluctuations that have affected the market prices of many technology and computer software companies, particularly Internet-related companies. Such fluctuations have often been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could adversely affect the market price of our Common Stock.

Further, securities class action litigation has often been brought against companies that experience periods of volatility in the market prices of their securities. Securities class action litigation could result in substantial costs and a diversion of our management's attention and resources.

***Our failure to maintain and increase acceptance of UltiPro, which accounts for substantially all of our revenues, could cause a significant decline in our revenues.***

Currently, the UltiPro solutions, including the UltiPro standard/HR payroll product and Optional Capabilities and related services, account for substantially all of our revenues. Our future success depends on maintaining and increasing acceptance of UltiPro. Any decrease in the demand for UltiPro would have a material adverse effect on our business, operating results and financial condition.

***We face risks associated with security breaches or cyber-attacks.***

We face risks associated with security breaches or cyber-attacks of our computer systems and those of our third-party representatives, vendors and service providers. Although we have implemented security procedures and controls to address these threats, our systems and our software products may still be vulnerable to breaches, data theft, computer viruses, programming errors, attacks by third parties, or similar disruptive problems.

If our systems, or the hosting systems at our third party owned data centers, were breached or attacked, the proprietary and confidential information of our company and our customers could be disclosed, and we may be required to incur substantial costs and liabilities, including the following:

- expenses to rectify the consequences of the security breach or cyber-attack;
- liability for stolen assets or information;
- costs of repairing damage to our systems;
- lost revenue and income resulting from any system downtime caused by such breach or attack;
- loss of competitive advantage if our proprietary information is obtained by competitors as a result of such breach or attack;
- increased costs of cyber security protection;
- costs of incentives we may be required to offer to our customers or business partners to retain their business; and
- damage to our reputation.

As a result, any compromise of security of our systems or cyber-attack could have a material adverse effect on our business, reputation, financial condition, and operating results.

***Our business may be adversely impacted if the ACA is repealed in its entirety or certain aspects of the ACA are repealed or changed as a result of recent political changes.***

The ACA remains subject to legislative efforts to repeal, modify or delay the implementation of the law. The recent Presidential and Congressional elections may result in additional or successful efforts to repeal, modify or delay implementation of all or certain aspects of the ACA. Generally, if the ACA is repealed or modified in whole or in part, or if implementation of certain aspects of the ACA is delayed, such repeal, modification or delay could adversely impact our existing and future business and operating results. For example, any such repeal, modification or delay could negatively impact the revenue we currently generate from our UltiPro ACA Toolkit or our UltiPro ACA Employer Services. While we expect continued challenges to the ACA, at this time we are unable to more precisely predict the full impact of any repeal, modification or delay in the implementation of the ACA.

***If our direct sales force is not successful, we may be unable to achieve significant revenue growth in the future.***

We sell our products and services primarily through our direct sales force. Our ability to achieve significant revenue growth in the future will depend upon the success of our direct sales force and our ability to adapt our sales efforts to address the evolving markets for our products. If our direct sales force does not perform as expected, our revenues could suffer.

***Our current and future competitors include companies with greater financial, technical and marketing resources than we have and if we are unable to compete successfully with other businesses in our industry or with in-house systems developed by potential customers, our profitability will be adversely affected.***

Our future success will depend significantly upon our ability to increase our share of our target market, to maintain and increase our recurring revenues from new and existing customers and to sell additional products, product enhancements, maintenance and support services and training and consulting services to existing and new customers. The HCM market is intensely competitive. Our competitors include:

- Large service bureaus, primarily ADP and, to a lesser extent, Ceridian;
- A number of companies, such as Oracle, Lawson, and Workday that offer HCM software products for use on mainframes, client/server environments and/or Web servers; and, in the UltiPro mid-market and strategic markets, payroll service providers such as ADP, Ceridian and Paychex that service companies on the smaller end of the mid-market; and
- The internal HR/payroll departments of potential customers which use custom-written software.

Our competitors may develop products that are superior to our products or achieve greater market acceptance. Many of our competitors or potential competitors have significantly greater financial, technical and marketing resources than we do. As a result, they may be able to respond more quickly to new or emerging technologies and to changes in customer requirements, or to devote greater resources to the development, promotion and sale of their products than we can. We believe that existing competitors and new market entrants will attempt to develop in-house systems that will compete with our products. We may be unable to compete successfully against current or future competitors. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address the needs of our prospective customers. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share.

***Our acquisitions of other companies, products, or technologies may result in operating difficulties, dilution, and other harmful consequences that may adversely impact our business and results of operations.***

As part of our overall business strategy, from time to time, we acquire complementary businesses, products and technologies. These transactions could be material to our financial condition and results of operations. We expect to continue to evaluate, and potentially enter into, acquisitions and a wide array of strategic transactions in the future.

We may not realize the anticipated benefits of our acquisitions to the extent that we anticipate, or at all, because acquisitions involve many risks, including:

- difficulties integrating the acquired operations, personnel, technologies, products or infrastructure;
- diversion of management's attention or other resources from other critical business operations and strategic priorities;
- unexpected difficulties encountered when we enter new markets in which we have little or no experience, or where competitors may have stronger market positions;
- inability to maintain relationships with customers and partners of the acquired business;
- the difficulty of incorporating acquired technology and rights into our products and services;

- potential unknown liabilities associated with an acquired business;
- unanticipated expenses related to integrating acquired technology with our existing technology;
- the impact on our results of operations due to depreciation and amortization related to acquired intangible assets, fixed assets and deferred compensation;
- the tax effects of any such acquisitions;
- potential litigation, such as claims by third parties related to intellectual property of the businesses we acquire;
- potential write-offs of our investments in acquired businesses;
- the need to implement controls, procedures and policies appropriate for a public company at companies that prior to the acquisition lacked such controls, procedures and policies; and
- challenges caused by distance, language and cultural differences.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and strategic transactions could cause us to fail to realize the anticipated benefits of such acquisitions or transactions, incur unanticipated liabilities, and harm our business generally.

We may issue additional equity securities to pay for future acquisitions or other strategic transactions, the issuance of which could be dilutive to our existing stockholders and affect the trading price of our securities. If any acquisition or other strategic transactions is not perceived as ultimately improving our financial condition and operating results, our stock price may decline. Further, if we fail to properly evaluate and execute acquisitions or other strategic transactions, our business and financial condition may be seriously harmed.

***Adverse changes in general economic or political conditions could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic and political conditions. If the state of the economy and the rate of employment deteriorate in the future, many customers may delay or reduce technology purchases. This could result in reductions in sales of our products, longer sales cycles, slower adoption of new technologies, increased price competition, customers purchasing fewer services or Optional Capabilities than they have in the past, customers requesting longer payment terms, customers failing to pay amounts due and slower collections of accounts receivable. In addition, increased unemployment could result in significant decreases in our recurring revenues from our existing customer base as we price our ongoing recurring revenues on a PEPM basis, subject, in many cases, to minimum employee sizes per customer. Any of these events would likely harm our business, results of operations, financial condition and cash flows from operations.

***The loss of the services of one or more of our key employees could negatively affect our ability to implement our business strategy.***

Our success depends to a significant extent upon a limited number of members of senior executive management and other key employees, including Scott Scherr, our Chairman of the Board of Directors, President and Chief Executive Officer. We do not have employment contracts with any of our key personnel. The loss of the services of one or more of our key employees could have a material adverse effect upon us. In addition, uncertainty created by turnover of our key employees could cause further turnover of our employees.

***If we are not able to successfully recruit personnel, our revenues could be negatively affected.***

Our ability to achieve significant revenue growth in the future will also depend on our success in recruiting, training and retaining sufficient sales, marketing, professional services, product development and other personnel.

***The potential growth of our business and expansion of our customer base may place a significant strain on our management and operations, and we may be unable to manage that growth and expansion successfully.***

We expect to increase research and development, professional services, sales and marketing and administrative operations as and when appropriate to accommodate our growth plans. Accordingly, our future operating results will depend on the ability of our management and other key employees to continue to implement and improve our systems for operations, financial control and information management and to recruit, train, manage and retain our employee base. We cannot be certain that we will be able to manage any future growth successfully.

***Our business relies heavily on the products of Microsoft, which may not always be compatible with our products, and we may be required to spend significant capital if businesses adopt alternative technologies that are incompatible with our products.***

Our software products are designed primarily to operate with Microsoft technologies and our strategy requires that our products and technology be compatible with new developments in Microsoft technology. Although we believe that Microsoft

technologies are currently widely utilized by businesses of all sizes, we cannot be certain that businesses will continue to adopt such technologies as anticipated, will migrate from older Microsoft technologies to newer Microsoft technologies or will not adopt alternative technologies that are incompatible with our products. As a result, we may be required to develop new products or improve our existing products to be compatible with different technologies that may be used by our customers. We cannot be certain we will be able to adapt our product to any technologies other than Microsoft's.

***If our third-party software is not adequately maintained or updated or independent third party's products that we market and distribute as part of the UltiPro solution are no longer available to us, our sales could be materially adversely affected.***

Certain products utilize software of third-party software developers or products from third parties from whom we have either purchased a license or the underlying source code of such software, entered into a service agreement with the vendor or have entered into a strategic alliance that gives us the right to market and distribute such product. Although we believe that there are alternatives for these products, any significant interruption in the availability of such third-party software or products could have a material adverse impact on our sales unless and until we can replace the functionality provided by these products. Additionally, we are, to a certain extent, dependent upon such third parties' abilities to enhance their current products, to develop new products on a timely and cost-effective basis and to respond to emerging industry standards and other technological changes. We may be unable to replace the functionality provided by the third-party software or products currently offered in conjunction with our products in the event that such software or products become obsolete or incompatible with future versions of our products or are otherwise not adequately maintained, updated or available.

***If we are unable to release annual or periodic updates on a timely basis to reflect changes in tax laws and regulations or other regulatory provisions applicable to our products, the market acceptance of our products may be adversely affected and our revenues could decline.***

Our products are affected by changes in tax laws and regulations and generally must be updated annually or periodically to maintain their accuracy and competitiveness. We cannot be certain that we will be able to release these annual or periodic updates on a timely basis in the future. Failure to do so could have a material adverse effect on market acceptance of our products. In addition, significant changes in tax laws and regulations or other regulatory provisions applicable to our products could require us to make a significant investment in product modifications, which could result in significant unexpected costs to us.

***If we are unable to protect our proprietary rights against unauthorized third-party copying or use, our revenues or our methods of doing business could be negatively impacted.***

Our success is dependent, in part, on our ability to protect our proprietary rights. We rely on a combination of copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We do not have any patents or patent applications pending, and existing copyright, trademark and trade secret laws afford only limited protection. As a result, we cannot be certain that we will be able to protect our proprietary rights against unauthorized third-party copying or use. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. In addition, others may develop products that perform comparably to our proprietary products. Policing the unauthorized use of our products is difficult.

***Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trademarks, copyrights or trade secrets or to determine the validity and scope of the proprietary rights of others; such litigation may be expensive and divert the attention of management.***

Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trademarks, copyrights or trade secrets or to determine the validity and scope of the proprietary rights of others. Any litigation could result in substantial costs and diversion of resources and management attention.

As is common in the software industry, from time to time we may become aware of third-party claims of infringement by our operations or products of third-party proprietary rights. While we are not currently aware of any such material claim, our software products may increasingly be subject to such claims as the number of products and competitors in our industry grows, as the functionality of products overlaps and as the issuance of software patents becomes increasingly common. Any such claims, with or without merit, can be time consuming and expensive to defend, cause product shipment delays or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, or at all.

***Defects and errors in our software could affect market acceptance of our products.***

Software products such as those offered by us may contain undetected errors or failures when first introduced or as new versions are released. Testing of our products is particularly challenging because it is difficult to simulate the wide variety of computing environments in which our customers may use these products. Despite extensive testing, from time to time we have discovered defects or errors in our products. Defects and errors may:

- Cause delays in product introductions and shipments;
- Result in increased costs and diversion of development resources;
- Require design modifications; or
- Decrease market acceptance of, or customer satisfaction with, our products.

Despite testing by us and by current and potential customers, errors may be found after commencement of commercial shipments, which may result in loss of or delay in market acceptance which could have a material adverse impact upon our business, operating results and financial condition.

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

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

***Anti-takeover provisions in our certificate of incorporation and by-laws and under our Amended and Restated Rights Agreement and Delaware law could substantially increase the cost to acquire us or prevent or delay a change in control and, as a result, negatively impact our stockholders and the price of our Common Stock.***

We have taken a number of actions that could have the effect of discouraging a takeover attempt. For example, we have adopted an Amended and Restated Rights Agreement that would cause substantial dilution to a stockholder, and substantially increase the cost paid by a stockholder, who attempts to acquire us on terms not approved by our Board of Directors. This rights plan could prevent us from being acquired.

Our Board of Directors is divided into three classes, each of whose members serve for a staggered three-year term. This board structure may prevent stockholders from changing the composition of our Board of Directors quickly.

In addition, our certificate of incorporation grants our Board of Directors the authority to fix the rights, preferences and privileges of and issue up to 2,500,000 shares of preferred stock without stockholder approval. Although we have no present intention to issue shares of preferred stock, such an issuance could have the effect of making it more difficult and less attractive for a third-party to acquire a majority of our outstanding voting stock. Preferred stock may also have other rights, including economic rights senior to our Common Stock, which could have a material adverse effect on our stock price.

We are also subject to the anti-takeover provisions of Section 203 of Delaware General Corporation Law. This section provides that a corporation may not engage in any business combination with any interested stockholder (as defined in that section) during the three-year period following the time that a stockholder became an interested stockholder. This provision could have the effect of delaying or preventing a change in control of our company.

***The growth of the international operations of our business subjects us to additional risks associated with foreign operations.***

International operations are subject to risks associated with operating outside of the United States. During the fourth fiscal quarter of 2006, we began operating in Canada (through the formation of a wholly-owned Canadian subsidiary). During 2016, we continued to grow our operations in Canada and Singapore. The financial impact of our international operations to our overall business has been insignificant to date. However, over time, our international operations may grow and increase their significance to our business. Sales to international customers subject us to a number of risks, including foreign currency fluctuations, unexpected changes in regulatory requirements for software, international economic and political instability, compliance with multiple, conflicting, and changing governmental laws and regulations, difficulty in staffing and managing foreign operations, international tax laws, potentially weaker protection for our intellectual property than in the United States, and difficulties in enforcing such rights abroad. If sales to any of our customers outside of the United States are delayed or canceled because of any of the above factors, our revenue may be negatively impacted.



Our international operations also increase our exposure to international laws and regulations. If we are unable to comply with foreign laws and regulations, which are often complex and subject to variation and unexpected changes, we could incur unexpected costs and potential litigation.

***If our goodwill or acquired intangible assets become impaired, we may be required to record a significant charge to earnings.***

Under U.S. generally accepted accounting principles, we review our acquired intangible assets for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered in circumstances indicating that the carrying value of our goodwill or acquired intangible assets may not be recoverable include a reduction in our market capitalization (as a result of a decline in our stock price) to a level below our consolidated stockholders' equity as of the applicable balance sheet date, declining future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our consolidated financial statements during the period in which any impairment of our goodwill or acquired intangible assets is determined, resulting in a negative impact on our results of operations.

***Changes in, or interpretations of, accounting principles could result in unfavorable accounting changes.***

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles and accompanying accounting pronouncements, implementation guidelines, and interpretations. Changes in these rules or their interpretation could significantly change our reported results and may even retroactively affect previously reported transactions. Our accounting principles that recently have been or may be affected by changes in accounting principles include, but are not limited to: recurring revenue recognition and accounting for income taxes.

***Changes in, or interpretations of, tax rules and regulations may adversely affect our effective tax rates.***

Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in tax laws or the interpretation of tax laws, or by changes in the valuation of our deferred tax assets and liabilities. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other domestic and foreign tax authorities. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that these potential examinations will not have an adverse effect on our operating results and financial position.

***Privacy concerns could result in regulatory changes that may harm our business.***

Personal privacy is a significant issue in the United States and in many other countries where our customers operate. The United States and many other countries have imposed restrictions and requirements on the use of personal information by those collecting such information. Changes to law or regulations affecting privacy, if applicable to our business or product, could impose additional costs and potential liability on us and could limit our use and disclosure of such information. If we were required to change our business activities or revise or eliminate services, our business could be harmed.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

Our corporate headquarters in Weston, Florida are at different locations in the city, which, in the aggregate, consist of approximately 305,000 square feet of leased space. We also have leased facilities in Atlanta, Georgia; Alpharetta, Georgia; Santa Ana, California; and Toronto, Canada.

Currently, we also lease satellite offices for certain field personnel in various locations throughout the United States and, to a much lesser extent, internationally. We believe that our existing facilities are suitable and adequate for our current operations for the next 12 months. We further believe that suitable space will be available as needed to accommodate any expansion of our operations on commercially reasonable terms.

## Item 3. Legal Proceedings

From time to time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. We are not currently a party to any legal proceedings the adverse outcome of which, individually or in the aggregate, could reasonably be expected to have a material adverse effect on our operating results or financial condition.

## Item 4. Mine Safety Disclosures

Not applicable.

## PART II

## Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information. The following table sets forth, for the periods indicated, the high and low sales prices of Ultimate's common stock, \$0.01 par value (the "Common Stock"), as quoted on the NASDAQ Global Select Market ("NASDAQ") under the symbol "ULTI."

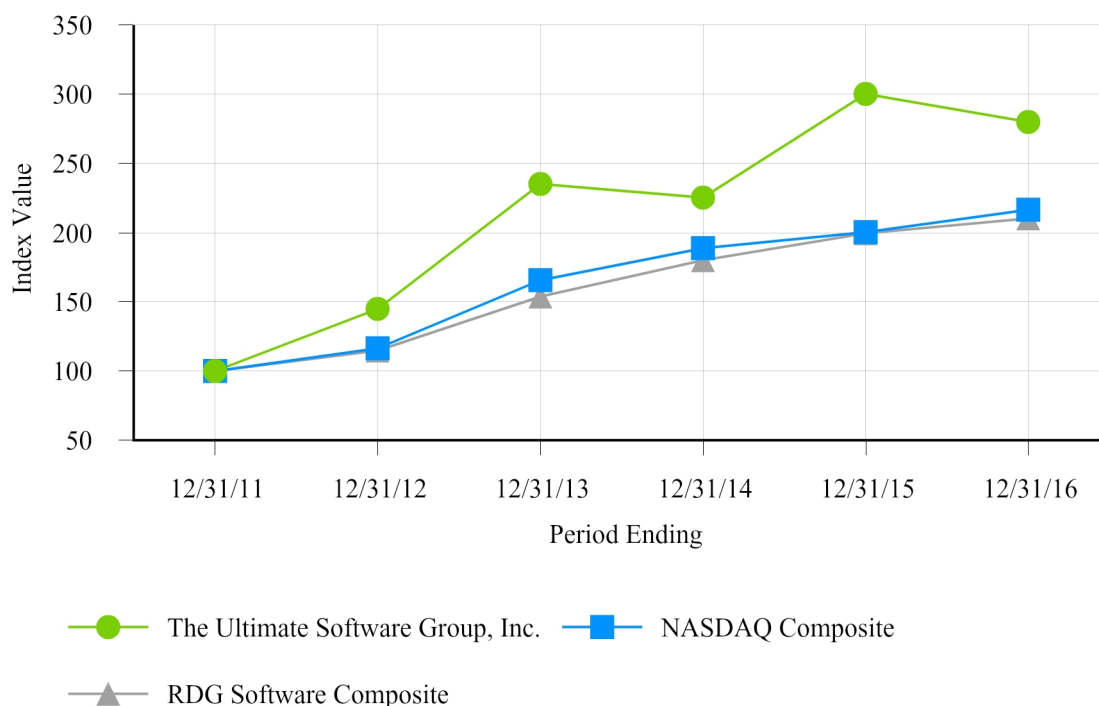
	2016		2015	
	High	Low	High	Low
First Quarter .....	\$194.70	\$148.26	\$174.12	\$139.32
Second Quarter .....	213.35	183.30	183.25	158.31
Third Quarter .....	224.07	200.19	195.18	162.01
Fourth Quarter .....	218.25	180.29	216.27	174.50

As of February 14, 2017, we had approximately 70 holders of record, representing approximately 5,466 stockholder accounts.

We have never declared or paid any cash dividends on our capital stock and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings to fund the development and growth of our business. The payment of dividends in the future, if any, will be at the discretion of our Board of Directors.

*Performance Graph.* The following graph compares the cumulative total stockholder returns on Ultimate’s Common Stock for the five year period covering December 31, 2011-December 31, 2016, on an annual basis, with the cumulative total return of the NASDAQ Composite Index and the RDG Software Composite Index for the same period.

**Comparison of 5 Year Cumulative Total Return \*  
Among the Ultimate Software Group, Inc., the NASDAQ Composite  
Index, and the RDG Software Composite Index**



\* \$100 invested on 12/31/11 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

*Purchases of Equity Securities by the Issuer.* On October 30, 2000, Ultimate announced that our Board of Directors authorized the repurchase of up to 1,000,000 shares of our outstanding Common Stock (the “Stock Repurchase Plan”).

On February 6, 2007, Ultimate’s Board of Directors extended the Stock Repurchase Plan by authorizing the repurchase of up to 1,000,000 additional shares of our issued and outstanding Common Stock.

On February 5, 2008, Ultimate’s Board of Directors extended the Stock Repurchase Plan further by authorizing the repurchase of up to 1,000,000 additional shares of our Common Stock.

On October 26, 2009, Ultimate’s Board of Directors extended the Stock Repurchase Plan further by authorizing the repurchase of up to 1,000,000 additional shares of our Common Stock.

On October 24, 2011, Ultimate’s Board of Directors extended the Stock Repurchase Plan further by authorizing the repurchase of up to 1,000,000 additional shares of our Common Stock.

On April 25, 2016, Ultimate's Board of Directors extended our Stock Repurchase Plan further by authorizing the repurchase of up to 1,000,000 additional shares of our Common Stock.

As of December 31, 2016, Ultimate had purchased 4,657,995 shares of our Common Stock under the Stock Repurchase Plan, with 1,342,005 shares available for repurchase in the future.

The number of shares of Common Stock repurchased by us during the three months ended December 31, 2016 is as indicated below:

<b>Period</b>	<b>Total Number of Shares Purchased (1)</b>	<b>Average Price Paid per Share</b>	<b>Total Cumulative Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs</b>
October 1 – 31, 2016 .....	—	—	4,657,995	1,342,005
November 1 – 30, 2016 .....	212,707 (1)	\$ 210.59	4,657,995	1,342,005
December 1 – 31, 2016 .....	324 (1)	\$ 182.35	4,657,995	1,342,005

(1) Represents shares of Common Stock that were acquired by us at the fair market value of the Common Stock as of the period stated, in connection with the satisfaction of our employees' tax withholding liability resulting from the vesting of restricted stock holdings.

**Item 6. Selected Financial Data**

The following selected consolidated financial data is qualified by reference to and should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Ultimate’s Consolidated Financial Statements and Notes thereto included elsewhere in this Form 10-K. The statements of income data presented below for each of the years in the three-year period ended December 31, 2016 and the balance sheet data as of December 31, 2016 and 2015 have been derived from our Consolidated Financial Statements included elsewhere in this Form 10-K.

	<b>Years Ended December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Statements of Income: (in thousands, except per share data)					
Revenues:					
Recurring .....	\$ 654,199	\$ 516,400	\$ 419,771	\$ 335,287	\$ 267,705
Services.....	127,092	101,681	86,165	75,110	64,563
Total revenues.....	<u>781,291</u>	<u>618,081</u>	<u>505,936</u>	<u>410,397</u>	<u>332,268</u>
Cost of revenues:					
Recurring .....	172,676	138,587	117,700	92,101	78,401
Services.....	127,433	99,948	85,939	76,577	66,063
Total cost of revenues.....	<u>300,109</u>	<u>238,535</u>	<u>203,639</u>	<u>168,678</u>	<u>144,464</u>
Gross profit .....	<u>481,182</u>	<u>379,546</u>	<u>302,297</u>	<u>241,719</u>	<u>187,804</u>
Operating expenses:					
Sales and marketing.....	224,416	169,664	117,033	93,879	72,565
Research and development.....	120,650	93,671	83,542	67,757	60,693
General and administrative.....	94,432	72,893	47,379	36,869	25,433
Total operating expenses.....	<u>439,498</u>	<u>336,228</u>	<u>247,954</u>	<u>198,505</u>	<u>158,691</u>
Operating income.....	<u>41,684</u>	<u>43,318</u>	<u>54,343</u>	<u>43,214</u>	<u>29,113</u>
Other (expense) income:					
Interest expense and other, net.....	(717)	(491)	(353)	(229)	(476)
Other income, net .....	451	256	339	104	102
Total other expense, net.....	<u>(266)</u>	<u>(235)</u>	<u>(14)</u>	<u>(125)</u>	<u>(374)</u>
Income before income taxes .....	<u>41,418</u>	<u>43,083</u>	<u>54,329</u>	<u>43,089</u>	<u>28,739</u>
Provision for income taxes .....	<u>(11,165)</u>	<u>(20,384)</u>	<u>(9,592)</u>	<u>(17,559)</u>	<u>(14,107)</u>
Net income .....	<u><u>30,253</u></u>	<u><u>22,699</u></u>	<u><u>44,737</u></u>	<u><u>25,530</u></u>	<u><u>14,632</u></u>
Net income per share: (1).....					
Basic .....	<u>\$ 1.04</u>	<u>\$ 0.79</u>	<u>\$ 1.58</u>	<u>\$ 0.92</u>	<u>\$ 0.55</u>
Diluted.....	<u>\$ 0.99</u>	<u>\$ 0.76</u>	<u>\$ 1.52</u>	<u>\$ 0.88</u>	<u>\$ 0.52</u>
Weighted average shares outstanding: (1)					
Basic .....	<u>28,976</u>	<u>28,634</u>	<u>28,293</u>	<u>27,773</u>	<u>26,778</u>
Diluted.....	<u>30,414</u>	<u>29,721</u>	<u>29,343</u>	<u>29,013</u>	<u>28,375</u>

**Balance Sheet Data:**

	<b>As of December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Cash and cash equivalents .....	\$ 73,773	\$ 109,325	\$ 108,298	\$ 79,794	\$ 58,817
Corporate investments in marketable securities .....	24,088	20,058	10,156	10,453	10,534
Total assets.....	<u>1,152,581</u>	<u>1,465,569</u>	<u>1,190,298</u>	<u>598,194</u>	<u>525,284</u>
Deferred revenue.....	173,976	145,727	109,705	103,184	91,976
Long-term borrowings, including capital lease obligations...	3,985	3,665	3,759	2,833	5,070
Stockholders' equity.....	<u>\$ 432,108</u>	<u>\$ 334,066</u>	<u>\$ 271,749</u>	<u>\$ 188,217</u>	<u>\$ 114,670</u>

(1) See Note 11 of the Notes to the Consolidated Financial Statements for information regarding the computation of net earnings per share.

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

Our Management's Discussion and Analysis of Financial Condition and Results of Operations provides information we believe is relevant to an assessment and understanding of our results of operations and financial condition. This discussion should be read in conjunction with our Consolidated Financial Statements and Notes that are included in this Form 10-K. Also, the discussion of Critical Accounting Policies and Estimates in this section is an integral part of the analysis of our results of operations and financial condition.

### Business Overview

Ultimate Software is a leading cloud provider of people management solutions, often referred to as human capital management ("HCM"). Ultimate's UltiPro product suite ("UltiPro") is a comprehensive, engaging solution that has human resources ("HR"), payroll, and benefits management at its core and includes global people management, available in twelve languages with more than 35 country-specific localizations. The solution is delivered via software-as-a-service ("SaaS") to organizations based in the United States and Canada, including those with global workforces. At the close of 2016, we had approximately 3,700 organizations as customers with approximately 33 million people records in our HCM cloud. We attained our leadership position, we believe, through our focus on unified HCM, people-centric product design, cloud technology, and strong customer relationships.

UltiPro is designed to deliver the functionality businesses need to manage the complete employee life cycle from recruitment to retirement and to facilitate employee engagement with their employers and each other. The solution includes unified feature sets for talent acquisition and onboarding, HR management and compliance, benefits management and online enrollment, payroll, performance management, compensation management with salary planning, budgeting and development of incentive plans, succession management, reporting and analytical decision-making and predictive tools, and time and attendance. UltiPro has role-based features for HR professionals, executives, managers, administrators, and employees whether they are in or out of the office, including access to business-critical information on mobile devices such as the iPhone, iPad, and other smartphones and tablets.

Our customers tell us that UltiPro helps them to streamline talent management, HR and payroll processes to significantly reduce administrative and operational costs while also empowering them to manage the talent in their workforces more strategically. UltiPro provides our customers with tools to analyze workforce trends for better decision making, identify high-performing talent within their organizations, predict who high-performers will be with a high degree of accuracy, find critical information quickly and perform routine business activities efficiently.

Our cloud offering of UltiPro provides Web-based access to comprehensive HCM functionality for organizations that want to simplify delivery and support of their business applications. We have found that UltiPro is attractive to companies that want to focus on their core competencies to increase sales and profits. Through UltiPro, we supply and manage the hardware, infrastructure, ongoing maintenance and backup services for our customers. Customer systems are currently managed at four data centers--one located near Atlanta, Georgia, one near Phoenix, Arizona, one near Toronto, Canada, and another near Vancouver, Canada. All data centers are owned and operated by independent third parties.

We market our UltiPro solutions primarily to enterprise companies, which we define as organizations with 2,501 or more employees, including those with 10,000 or more employees; mid-market companies, which we define as those having 501-2,500 employees; and strategic market companies, which we define as those having 100-500 employees. UltiPro is marketed primarily through our enterprise, mid-market and strategic direct sales teams. Our mid-market and strategic market customers have access to nearly all the features that our larger enterprise companies have through UltiPro, plus a bundled services package. Since many companies in the mid- and strategic markets do not have information technology ("IT") staff on their premises to help with system deployment or ongoing management issues, we have created a bundled services package to give these customers a high degree of convenience by handling system configuration, business rules, and other situations for them "behind the scenes." UltiPro is marketed primarily through our enterprise, mid-market and strategic direct sales teams.

In addition to UltiPro's HCM functionality, our customers have the option to purchase a number of additional capabilities on a per-employee-per-month ("PEPM") basis, which are available to enhance and complement the core functionality of UltiPro and which are based on the particular business needs of our customers. These optional UltiPro capabilities currently include (i) the talent acquisition suite (recruitment and onboarding); (ii) the talent management suite (performance management, talent predictors, and succession management); (iii) learning management; (iv) employee engagement surveys; (v) compensation management; (vi) benefits enrollment; (vii) time management; (viii) payment services (formerly referred to as "tax filing"); (ix) wage attachments; and (x) other optional features (collectively, "Optional Capabilities"), which are described below.

In the fall of 2015, Ultimate began deploying an ACA toolkit that enabled our customers to comply with ACA regulations by the 2016 deadline. The toolkit is embedded in UltiPro and automatically populates the Forms 1094-C and 1095-C with the appropriate information. In addition, Ultimate offers our customers additional optional ACA-related services, branded UltiPro ACA Employer Services. These include such services as printing and electronic filing of 1094-C and 1095-C forms with the IRS on our customer's behalf and on-going proactive monitoring and managing of employee eligibility alerts, notices, and penalty responses. UltiPro's tracking of hours worked in payroll ties to UltiPro's benefits management, enabling automatic calculation of employees' hours of service eligibility and providing HR leaders analytical insight into compliance risk related to the ACA delivered in the Healthcare Eligibility Dashboard and via our UltiPro ACA Toolkit.

All Optional Capabilities are priced solely on a subscription basis. Some of the Optional Capabilities are available to enterprise, mid-market and strategic market customers while others are available exclusively to either enterprise, mid-market or strategic market customers, and availability is based on the needs of the respective customers, the number of their employees and the complexity of their HCM environment.

The key drivers of our business are (i) growth in recurring revenues; (ii) operating income, excluding non-cash stock-based compensation, amortization of acquired intangibles ("Non-GAAP Operating Income"); and (iii) retention of our customers once our solutions are sold ("Customer Retention"). For the year ended December 31, 2016, our (i) recurring revenues grew by 26.7%, compared with the same period in 2015, and (ii) Non-GAAP Operating Income was \$157.6 million, or 20.2% of total revenues, as compared with \$126.8 million, or 20.5% of total revenues, for the same period in 2015. For the year ended December 31, 2015, our (i) recurring revenues grew by 23.1%, compared with the same period in 2014 and (ii) Non-GAAP Operating Income was \$126.8 million, or 20.5% of total revenues, as compared with \$101.7 million, or 20.1% of total revenues, for the same period in 2014. As of December 31, 2016, our Customer Retention, on a trailing twelve-month basis, was approximately 97% for our recurring revenue cloud customer base, compared with in excess of 97% for the prior year. See "Non-GAAP Financial Measures" below.

Our ability to achieve significant revenue growth in the future will depend upon the success of our direct sales force and our ability to adapt our sales efforts to address the evolving markets for our products and services. We provide our sales personnel with comprehensive and continuing training with respect to technology and market place developments. Aside from sales commissions, we also provide various incentives to encourage our sales representatives, including stock-based compensation awards based upon performance.

The HCM market is intensely competitive. We address competitive pressures through improvements and enhancements to our products and services, the development of additional features of UltiPro and a comprehensive marketing team and process that distinguishes Ultimate and its products from the competition. Our focus on customer service, which enables us to maintain a high Customer Retention rate, also helps us address competitive pressures.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. If general economic conditions were to deteriorate, we may experience delays in our sales cycles, increased pressure from prospective customers to offer discounts and increased pressure from existing customers to renew expiring recurring revenue agreements for lower amounts. We address continuing economic pressures by, among other things, efforts to control growth of our operating expenses through the monitoring of controllable costs and vendor negotiations.

Ultimate has two primary revenue sources: recurring revenues and services revenues. Prior to December 31, 2014, subscription revenues from UltiPro and maintenance revenues were the primary components of recurring revenues. Effective January 1, 2015, the primary component of recurring revenues is subscription revenues from UltiPro for the reasons discussed below. The majority of services revenues are derived from implementation consulting services.

Subsequent to the discontinuation of selling perpetual licenses of UltiPro to new customers, which occurred in 2009, we sold licenses to existing license customers but only in relation to the customer's employee growth or for Optional Capabilities if the customer already had a perpetual license for the on-site UltiPro solutions. As perpetual license agreements were sold in the past, annual maintenance contracts (priced as a percentage of the related license fee) accompanied those agreements. Maintenance contracts typically had a one-year term with annual renewal periods thereafter. Since 2009 and through December 31, 2014, our maintenance revenues were related to renewal maintenance only. In 2012, we announced that we would no longer support the licensed UltiPro ("Legacy") products after December 31, 2014. In the approximate two-year period after the announcement, Ultimate strengthened its campaign to convert Legacy customers to cloud customers. Effective January 1, 2015, we no longer have maintenance revenues associated with our Legacy customers. Ultimate believes this campaign for Legacy to cloud conversions was successful. Since 2009, with the sunseting of the Legacy product, effective December 31, 2014, a majority of our Legacy customers made the transition to the cloud.



As cloud units are sold, the recurring revenue backlog associated with UltiPro grows, enhancing the predictability of future revenue streams. Cloud revenues include ongoing monthly subscription fees, priced on a PEPM basis. Revenue recognition for our recurring revenue stream is typically triggered when the customer processes its first payroll using UltiPro (or goes “Live”).

## **Acquisitions**

On September 29, 2016, pursuant to a merger agreement, we acquired Kanjoya, Inc., ("Kanjoya") a California corporation. Kanjoya is a leading cloud workforce intelligence provider for enterprises. Based upon the technology acquired, we launched UltiPro Perception, a feature-set that enables businesses to identify and analyze attitudes and performance traits of their employees, managers, and teams from surveys and other sources of employee feedback. Kanjoya's experienced workforce has joined Ultimate and will serve to establish an additional research and development hub for us in San Francisco. See Note 4 of the Notes to Consolidated Financial Statements.

On May 11, 2016, we acquired certain assets and assumed certain liabilities of Capital Analytics, Inc., (d/b/a Vestrics), a Delaware corporation located in North Carolina. Vestrics' predictive technology enables a company to identify and analyze the connections between its investments in human capital and the performance-related business results of those investments. We will leverage Vestrics' technology as we continue to expand our analytics capabilities across UltiPro. Vestrics' experienced workforce has joined Ultimate and we believe they will benefit Ultimate's development efforts in the long-run. See Note 4 of the Notes to Consolidated Financial Statements.

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, costs and expenses, and related disclosures during the reporting period. Actual results could differ from those estimates.

We believe that of our significant accounting policies, which are described in Note 3, "Summary of Significant Accounting Policies and Recent Accounting Pronouncements," to our consolidated financial statements, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our consolidated financial condition and results of operations.

### ***Revenue Recognition***

We recognize revenues in accordance with Accounting Standards Update ("ASU") No. 2009-13, “Multiple-Deliverable Revenue Arrangements” (“ASU 2009-13”). We use the relative selling price method to allocate the total consideration to units of accounting in a multiple element arrangement. We allocate revenue in an arrangement using the estimated selling price (“ESP”) of deliverables if it does not have vendor-specific objective evidence (“VSOE”) or third-party evidence (“TPE”) of selling price.

VSOE is the price charged when the same or similar product or service is sold separately. We define VSOE as a median price of recent stand-alone transactions that are priced within a narrow range.

TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. However, due to the difficulty in obtaining sufficient information on competitor pricing and differences in our product offerings when compared with those of our peers, we generally are unable to reliably determine TPE.

ESP is our best estimate of the selling price of an element in a transaction. If we are unable to establish selling price using either VSOE or TPE, we will use ESP in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact business if the product or service were sold by us on a stand-alone basis. Our determination of ESP involves the use of a customary discount from the list (or book) price for each element, with the discounted price applied within a narrow range. The customary discount is derived from historical data that has been analyzed to determine trends and patterns. We analyze the customary discount used for determining ESP on no less than an annual basis.

We evaluate each deliverable in our arrangements to determine whether it represents a separate unit of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value to our customers. Our products and services continue to qualify as separate units of accounting under ASU 2009-13.

There are two major elements in our multiple element arrangements for the delivery of our UltiPro offering, which are recurring revenues (i.e., cloud subscription revenues) and services revenues (mostly implementation consulting services).

For multiple element arrangements, the consideration allocated to cloud subscription revenues is recognized as recurring revenues over the initial contract period, as those subscription-based services are delivered, typically commencing with the Live date of the related product. The consideration allocated to fixed fee implementation consulting services in multiple element arrangements is recognized as services revenues on a percentage of completion basis, using reasonably dependable estimates with respect to milestones achieved (in relation to progression through implementation phases), by product.

Single element arrangements typically consist of renewals for cloud subscriptions and implementation consulting services sold on a time and materials basis. Under these single element arrangements, cloud subscription revenues are recognized over the related renewal period, as the services are delivered, and implementation consulting services are recognized as the related time and materials services are performed.

We recognize revenues when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the fees are fixed and determinable; and
- collection is considered probable.

If collection is not considered probable, we recognize revenues when the fees are collected. If the fees are not fixed and determinable, we recognize revenues when the fees become due from the customer. If non-standard acceptance periods or non-standard performance criteria are required, we recognize revenue when the acceptance period expires or upon the satisfaction of the acceptance/performance criteria, as applicable.

The majority of services revenues are recognized over the implementation period, which is from the contract execution date until the Live date. Cloud revenues are recognized over the initial contract term, typically beginning in the month the customer goes Live.

### **Recurring Revenues**

Recurring revenues primarily consist of subscription revenues recognized from our customers' use of UltiPro after they have gone Live.

i) Cloud subscription revenues are principally derived from PEPM fees earned from UltiPro units that are Live. Ongoing PEPM fees are recognized as subscription revenues as the services are delivered, typically commencing when the customer goes Live.

ii) Effective January 1, 2015, we no longer have maintenance revenues associated with our Legacy customers and we stopped supporting our Legacy customers after December 31, 2014. Since the time we announced that we would stop supporting our Legacy product in 2012, we successfully converted the majority of our Legacy customers to the cloud. Those customers that did not convert terminated.

With UltiPro, our customers do not have the right to take possession of our software and these arrangements are considered service contracts. The selling price of multiple deliverables in cloud arrangements is derived for each element based on the guidance provided by ASU 2009-13. The multiple elements that typically exist in cloud arrangements include (1) recurring revenues from the combination of hosting services, the right to use UltiPro, and maintenance of UltiPro (i.e., product enhancements, updates and customer support) and (2) professional services (i.e., primarily implementation consulting services).

The pricing for the three elements that pertain to recurring revenues (i.e., hosting services, the right to use UltiPro and maintenance of UltiPro (as described above) is bundled. Since these three bundled elements are components of recurring revenues in the consolidated statements of income, allocation of selling price to each of the three elements is not necessary and they are not reported separately. Selling price, which is established through VSOE, for the bundled elements, as a whole, is determined on the basis of renewal pricing, without taking into consideration potential price increases or potential changes in the number of employees of the customer in the future due to the uncertainties surrounding these potential occurrences. These bundled elements are provided on an ongoing basis, represent undelivered elements and are recognized on a monthly basis as the related services are performed, commencing once the customer goes Live.

### **Services Revenues**

Services revenues primarily include revenues from fees charged for implementation consulting services in connection with the implementation of our product solutions and, to a much lesser extent, fees for other services, including the provision of payroll-related forms, sales of time clocks and printing services for certain customers, as well as certain client reimbursable out-of-pocket expenses.

Our multiple element contracts contain recurring cloud revenues and implementation consulting services priced on a fixed fee basis. Time and materials implementation consulting services are sold as stand-alone sales not directly related to the basic implementation of the cloud product. The total arrangement consideration is allocated to services elements in the arrangement based on relative selling prices, using the prices established when the services are sold on a stand-alone basis. Selling price is established through ESP for fixed fee implementation consulting services that are included in our multiple element contracts.

Revenues from implementation consulting services sold on a fixed-fee basis are recognized using the percentage of completion accounting method, which involves the use of estimates. Percentage of completion is measured at each reporting date based on progress made to date, using reasonably dependable estimates with respect to milestones achieved or billable hours, as applicable.

Revenues from implementation consulting services, billed on a time and materials basis (at an hourly rate), are recognized as these services are performed. Other services are recognized as the product is shipped or as the services are rendered, depending on the specific terms of the related arrangement.

### ***Capitalized Internal-Use Software Costs***

We follow the guidance of Accounting Standards Codification ("ASC") Topic 350-40, "Intangibles Goodwill and Other-Internal Use Software" ("ASC 350"), in accounting for costs related to software developed for internal use. ASC 350 requires companies to capitalize qualifying computer software costs, which are incurred during the application development stage. Costs capitalized during the application development stage include external direct costs of materials and services consumed in developing or obtaining internal-use software and payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the internal-use computer software. In addition to capitalizing costs for software (which are used by us in our general operations, for internal purposes), we also capitalize costs under ASC Topic 350-40 for certain software development projects related to our suite of products sold to our customers exclusively on a subscription basis under our software-as-a-service ("SaaS") offering of UltiPro.

Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life. We evaluate the useful lives of these assets on an annual basis and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. To the extent there is amortization of capitalized costs associated with development projects for UltiPro sold to our customers on a SaaS basis, the related amortization is included with cost of recurring revenues upon the commencement of that amortization period.

### ***Goodwill and Intangible Assets***

The purchase price of an acquired company is allocated between intangible assets and the net tangible assets of the acquired business with the residual of the purchase price recorded as goodwill. The determination of the value of the intangible assets acquired involves certain judgments and estimates. These judgments and estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future and the appropriate weighted average cost of capital.

At December 31, 2016, our goodwill totaled \$35.3 million and our identifiable net intangible assets totaled \$23.9 million. We assess the impairment of goodwill of our reporting units annually, or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is tested for impairment at the reporting unit level by first performing a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying value. If the reporting unit does not pass the qualitative assessment, then the reporting unit's carrying value is compared to its fair value to the extent necessary. Goodwill is considered impaired if the carrying value of the reporting unit exceeds its fair value. The discounted cash flow approach uses expected future operating results. Failure to achieve these expected results may cause a future impairment of goodwill at the reporting unit. We conducted our annual impairment tests of goodwill as of December 31, 2016, 2015 and 2014. As a result of this test, we determined that the fair value was in excess of the carrying value.

We evaluate our intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset or group of assets. The amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. We also evaluate the estimated remaining useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. Assumptions and estimates about future values and remaining useful lives of our intangible assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends and internal factors such as changes in our business strategy and our internal forecasts.

### ***Income Taxes***

We make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes.

Ultimate assesses the likelihood that it will be able to recover its deferred tax assets. Management considers all available evidence, both positive and negative, including historical levels of pre-tax book income, expiration of net operating loss carryforwards, expectations and risks associated with estimates of future taxable income and ongoing prudent and feasible tax planning strategies as well as current tax laws and interpretation of current tax laws in assessing the need for a valuation allowance. If recovery is not likely, we record a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. The available positive evidence at December 31, 2016 included, among other factors, three years of cumulative historical pre-tax book income and a projection of future pre-tax book income and taxable income. As a result of our analysis of all available evidence, both positive and negative, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize all of the deferred tax assets as of December 31, 2016. As such, there was no valuation allowance for the years ended December 31, 2016, 2015 and 2014.

### ***Allowance for Doubtful Accounts***

We perform credit evaluations of our customers to assess their ability to make payments to us for our products and services. We maintain an allowance for doubtful accounts at an amount estimated to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on accounts receivable. A considerable amount of judgment is required in determining the amount of our allowance for doubtful accounts, including assessing the probability of collection and current credit-worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in further impairment of their ability to make payments, an additional provision for doubtful accounts may be required.

## Results of Operations

The following table sets forth the consolidated statements of income data of Ultimate, as a percentage of total revenues, for the periods indicated.

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Revenues:			
Recurring .....	83.7%	83.5%	83.0%
Services .....	16.3	16.5	17.0
Total revenues .....	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Cost of revenues:			
Recurring .....	22.1	22.4	23.2
Services .....	16.3	16.2	17.0
Total cost of revenues .....	<u>38.4</u>	<u>38.6</u>	<u>40.2</u>
Gross profit .....	<u>61.6</u>	<u>61.4</u>	<u>59.8</u>
Operating expenses:			
Sales and marketing .....	28.7	27.4	23.1
Research and development .....	15.5	15.2	16.5
General and administrative .....	12.1	11.8	9.4
Total operating expenses .....	<u>56.3</u>	<u>54.4</u>	<u>49.0</u>
Operating income .....	5.3	7.0	10.8
Other income (expense):			
Interest expense and other, net .....	(0.1)	(0.1)	(0.1)
Total other expense, net .....	0.1	—	—
Total other income (expense), net .....	—	(0.1)	(0.1)
Income before income taxes .....	5.3	6.9	10.7
Provision for income taxes .....	(1.4)	(3.2)	(1.9)
Net income .....	<u>3.9%</u>	<u>3.7%</u>	<u>8.8%</u>

The following table sets forth the non-cash stock-based compensation expense resulting from stock-based arrangements that is recorded in our consolidated statements of income for the periods indicated (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cost of recurring revenues .....	\$ 8,613	\$ 6,303	\$ 5,495
Cost of services revenues .....	6,198	5,017	4,446
Sales and marketing .....	59,187	41,059	20,767
Research and development .....	8,238	6,180	4,788
General and administrative .....	31,641	23,857	10,689
Total stock-based compensation expense .....	<u>\$ 113,877</u>	<u>\$ 82,416</u>	<u>\$ 46,185</u>

## Overview of Financial Results

For the year ended December 31, 2016, compared with the year ended December 31, 2015, total revenues increased by \$163.2 million and our total cost of revenues and operating expenses, combined, increased by \$164.8 million, resulting in our operating income decreasing by \$1.6 million.

During the years ended December 31, 2016 and 2015, our non-cash stock-based compensation expense increased \$31.5 million and \$36.2 million, respectively, primarily as the result of changes we made with respect to our change in control plans ("CIC Plans") for certain senior officers. As part of an on-going comprehensive review of our senior officers'

compensation arrangements, the Board of Directors and the Compensation Committee took actions to modify the CIC Plans primarily to better align management's incentives with long-term value creation for our shareholders, by significantly amending the CIC Plan I (in March 2015 and February 2016), which covered Mr. Scott Scherr, our Chairman of the Board, President and Chief Executive Officer, Mr. Marc D. Scherr, our Vice Chairman of the Board and Chief Operating Officer, and Mr. Mitchell K. Dauerman, our Executive Vice President, Chief Financial Officer and Treasurer, and terminating our CIC Plan II (in March 2015), which covered eight other senior officers of the Company (collectively, the "CIC Plan Revisions"). The CIC Plans were designed to provide cash payments to senior officers covered by the respective plans upon a "change in control" of Ultimate Software. The CIC Plans were originally established in 2004 in lieu of granting time-based equity awards, and they were amended in 2007 to increase the size of the control awards, again in lieu of granting time-based equity awards. Under the terms of each of the CIC Plans, we were required to provide each covered senior officer with "comparable value" with respect to the reduction or termination of his or her change in control award. The comparable value given to each such senior officer was in the form of a restricted stock award. These restricted stock awards granted in March 2015 and February 2016 in connection with the CIC Plan Revisions accounted for \$19.7 million of the \$31.5 million increase in our non-cash stock-based compensation expense for the year ended December 31, 2016 and \$23.0 million of the \$36.2 million increase in our non-cash stock-based compensation expense for the year ended December 31, 2015. The remaining increases were due to the effects of new grants in each year and the impact of changes in our stock price.

The following table sets forth the stock-based compensation expense associated with modifications made to the Company's change in control plans as discussed above (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Stock-based compensation expense:</b>			
Stock-based compensation expense .....	\$ 71,119	\$ 59,390	\$ 46,185
Stock-based compensation expense related to CIC modifications .....	42,758	23,026	—
Total non-cash stock-based compensation expense.....	<u>\$ 113,877</u>	<u>\$ 82,416</u>	<u>\$ 46,185</u>

In connection with the ongoing review of executive compensation, on February 6, 2017, our Board of Directors approved the termination of the CIC Plan and all remaining awards that were outstanding under the CIC Plan.

Pursuant to the terms of the CIC Plan, in connection with the termination of these awards, the Company was required to provide each of the participants with an arrangement of comparable value as determined by our Compensation Committee in good faith. The comparable value was provided to the participants in the CIC Plan in the form of grants of restricted stock. In connection with its determination to use restricted stock grants for this purpose, the Compensation Committee considered the management retention incentives associated with restricted stock that vests over a period of time. Mr. Scott Scherr was awarded a restricted stock award of 157,270 shares of the Company's Common Stock with a date of grant of February 10, 2017. Mr. Marc D. Scherr was awarded 157,270 shares of the Company's Common Stock with a date of grant of February 10, 2017. Mr. Mitchell K. Dauerman was awarded 39,317 shares of the Company's Common Stock with a date of grant of February 10, 2017. Each of these restricted stock awards vests one-third on each of the following dates: February 10, 2018, February 10, 2019 and February 10, 2020, assuming continued employment with the Company as of such dates and subject to accelerated vesting in the event of a change in control or termination of employment due to death or disability. Based on an assumed stock price of \$195.61, the closing price of the Company's Common Stock on February 10, 2017, the value of the restricted stock awards to Mr. Scott Scherr, Mr. Marc D. Scherr and Mr. Mitchell K. Dauerman would be approximately \$30.8 million, \$30.8 million and \$7.7 million, respectively. The restricted stock awards were granted under our Amended and Restated 2005 Equity and Incentive Plan.

Our net income for the year ended December 31, 2016 increased \$7.6 million primarily as a result of early adoption of Accounting Standards Update ("ASU") 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09") during our third quarter of 2016, which was partially offset by an increase in stock-based compensation primarily for the reasons described above. The primary impact of the adoption of ASU 2016-09 was the recognition of excess tax benefits in our provision for income taxes, rather than paid-in capital, for all periods in fiscal year 2016.

### **Comparison of Fiscal Years Ended December 31, 2016 and 2015**

#### *Revenues*

Our revenues are derived from recurring revenues and services revenues. See "Revenue Recognition" above for further discussion of Ultimate's revenue sources and its method of accounting for each of them.

Total revenues increased 26.4% to \$781.3 million for 2016 from \$618.1 million for 2015.

Recurring revenues, consisting of subscription revenues from cloud-based UltiPro, increased 26.7% to \$654.2 million for 2016 from \$516.4 million for 2015. The increase in recurring revenues for 2016 was primarily based on the revenue impact of incremental units sold to customers that have processed their first payroll using UltiPro (or gone "Live") since December 31, 2015, including the UltiPro core product and, to a lesser extent, Optional Capabilities of UltiPro. Cloud subscription revenues are recognized as recurring revenues over the initial contract period, as those services are delivered, typically commencing with the Live date.

Our annual revenue customer retention rate for our recurring revenue cloud customer was approximately 97% at the end of 2016 (calculated on a 12-month rolling basis) which compared with in excess of 97% for the prior year comparable period. The impact on recurring revenues of UltiPro units sold has been a gradual increase from one reporting period to the next, based on the incremental effect of revenue recognition of the subscription fees over the terms of the related contracts as sales in backlog go Live.

Services revenues increased 25.0% to \$127.1 million for 2016 from \$101.7 million for 2015. The increase in services revenues for the year was primarily due to additional implementation revenues from incremental billable consultants to support increased sales, particularly from our mid-market and strategic sales channels and, to a lesser extent, as a result of increased fixed fee implementations primarily in association with interfaces with UltiPro. In addition, other services revenues increased primarily from additional print services provided to our customers (which occurred in the first quarter of 2016).

### *Cost of Revenues*

Cost of revenues consists of the costs of recurring and services revenues. Cost of recurring revenues primarily consists of costs to provide customer support services ("Customer Support") to cloud customers, the cost of providing periodic updates and the cost of recurring subscription revenues, including hosting data center costs and, to a lesser extent, amortization of capitalized software. Cost of services revenues primarily consists of costs to provide implementation services and training to Ultimate's customers and, to a lesser extent, costs related to sales of payroll-related forms, time clocks and print services, as well as costs associated with certain client reimbursable out-of-pocket expenses.

Total cost of revenues increased 25.8% to \$300.1 million for 2016, from \$238.5 million for 2015.

Cost of recurring revenues increased 24.6% to \$172.7 million for 2016 from \$138.6 million for 2015. The \$34.1 million increase in the cost of recurring revenues for the year was primarily due to increases in both cloud costs and Customer Support costs, as described below:

- For the year ended December 31, 2016, the increases in cloud costs were principally as a result of the growth in cloud operations from increased sales, including increased labor costs and, to a lesser extent, increased variable costs associated with our cloud operations.
- The increase in Customer Support costs for the year ended December 31, 2016 was primarily due to higher labor costs commensurate with the growth in the number of cloud customers serviced.

Cost of services revenues increased 27.5% to \$127.4 million for 2016 from \$99.9 million for 2015. The \$27.5 million increase in cost of services revenues was primarily due to an increase in the cost of implementation, including higher labor and related costs, particularly in association with the increased number of implementation consultants and the increased use of third-party implementation partners.

### *Sales and Marketing*

Sales and marketing expenses consist primarily of salaries and benefits, sales commissions, travel and promotional expenses, and facility and communication costs for direct sales offices, as well as advertising and marketing costs. Sales and marketing expenses increased 32.3% to \$224.4 million for 2016 from \$169.7 million for 2015. The \$54.8 million increase in sales and marketing during 2016 was primarily due to increased labor and related costs (including the impact of an increase in sales personnel, primarily in our mid-market and strategic sales channels, and higher sales commissions) and higher advertising and marketing expenses, which included media advertising. Included in the increased labor and related costs for the 2016 year was a portion of certain non-cash, stock-based compensation expenses relating to the CIC Plan Revisions. Commissions on subscription-based cloud sales are amortized over the initial contract term (typically 24 to 36 months) typically commencing on the Live date, which corresponds with the related cloud revenue recognition.

## *Research and Development*

Research and development expenses consist primarily of software development personnel costs. Research and development expenses increased 28.8% to \$120.7 million in 2016 from \$93.7 million in 2015. The \$27.0 million increase in research and development expenses during 2016 was principally due to higher labor and related costs associated with the ongoing development of UltiPro and Optional Capabilities, including the impact of increased personnel costs (predominantly from additional headcount), net of capitalized labor costs. For the years ended December 31, 2016 and 2015, we capitalized \$37.9 million (including \$3.9 million in non-cash stock-based compensation) and \$26.3 million (including \$3.0 million in non-cash stock-based compensation), respectively, of computer software development costs related to an internal-use development project for our UltiPro product offering (the "Development Project"). The capitalized costs for the Development Project were primarily from direct labor costs and, to a lesser extent, third party consulting fees for the years ended December 31, 2016, 2015 and 2014. For each of 2016 and 2015, we recognized \$1.1 million of amortization costs which were associated with a particular product module, of the Development Project, UltiPro Recruiting, which was ready for its intended use during the second quarter of 2014. In addition, another product module of the Development Project, UltiPro Onboarding, became ready for its intended use in mid-December 2016; the amortization related to the commencement of the amortization for UltiPro Onboarding was insignificant for the 2016 year. The amortization of capitalized software is included in cost of recurring revenues.

## *General and Administrative*

General and administrative expenses consist primarily of salaries and benefits of executive, administrative and financial personnel, as well as facility costs, external professional fees and the provision for doubtful accounts. General and administrative expenses increased by 29.5% to \$94.4 million for 2016 from \$72.9 million for 2015. The \$21.5 million increase in general and administrative expenses during 2016 was primarily due to higher labor and related costs, including increased personnel to support Ultimate's growth in operations, an increase in facility costs to support the growth in headcount, including our Weston, Florida headquarter locations, increased professional fees and a portion of certain non-cash, stock-based compensation expenses for the CIC Plan Revisions.

## *Provision for Income Taxes*

In 2016, based on pre-tax income, we had income tax expense of \$11.2 million as compared to \$20.4 million in 2015. The decrease in income tax expense of \$9.2 million was primarily due to the early adoption of ASU 2016-09 (see Note 3 in Notes to Consolidated Financial Statements), partially offset by an increase in non-deductible expenses, primarily stock based compensation, and a resulting higher ratio of non-deductible expenses to pre-tax income. Ultimate recorded \$4.0 million and \$3.2 million of research and development tax credit carryforwards during the years ended December 31, 2016 and December 31, 2015, respectively.

## **Comparison of Fiscal Years Ended December 31, 2015 and 2014**

### *Revenues*

Total revenues, primarily consisting of recurring and services revenues, increased 22.2% to \$618.1 million for 2015 from \$505.9 million for 2014.

Recurring revenues increased 23.1% to \$516.2 million for 2015 from \$419.2 million for 2014. The increase in recurring revenues for 2015 was primarily due to an increase in subscription revenues from UltiPro.

- The increase in cloud revenues was primarily based on the revenue impact of incremental units sold that have gone Live since December 31, 2014, including the UltiPro core product and, to a lesser extent, Optional Capabilities of UltiPro. Cloud subscription revenues are recognized as recurring revenues over the initial contract period, as those services are delivered, typically commencing with the Live date.
- Effective January 1, 2015, we no longer had maintenance revenues associated with our Legacy customers. Since the time we announced that we would stop supporting our Legacy product in 2012, we successfully converted the majority of our Legacy customers to the cloud. Those customers that did not convert terminated.

Our annual revenue customer retention rate for our recurring revenue cloud customer base exceeded 97% at the end of 2015 (calculated on a 12-month rolling basis) which compared with greater than 96% for 2014. The impact on recurring revenues of UltiPro units sold has been a gradual increase from one reporting period to the next, based on the incremental effect of revenue recognition of the subscription fees over the terms of the related contracts as sales in backlog go Live.



Services revenues increased 18.0% to \$101.7 million for 2015 from \$86.2 million for 2014. The increase in services revenues for the year was primarily due to additional implementation revenues from incremental billable consultants to support increased sales, particularly from our Mid-market and Strategic market sales channels and, to a lesser extent, as a result of increased fixed fee implementations.

### *Cost of Revenues*

Cost of revenues primarily consists of the costs of recurring and services revenues. Cost of recurring revenues primarily consists of costs to provide customer support services ("Customer Support") to cloud customers, the cost of providing periodic updates and other costs of recurring subscription revenues, including hosting data center costs and, to a lesser extent, amortization of capitalized software. Cost of services revenues primarily consists of costs to provide implementation services and training to Ultimate's customers and, to a lesser extent, costs related to sales of payroll-related forms, time clocks and Form W-2 services, as well as costs associated with certain client reimbursable out-of-pocket expenses.

Cost of recurring revenues increased 17.8% to \$138.5 million for 2015 from \$117.6 million for 2014. The \$20.9 million increase in the cost of recurring revenues for the year was primarily due to increases in both cloud costs and Customer Support costs, as described below:

- For the year ended December 31, 2015, the increases in cloud costs were principally as a result of the growth in cloud operations from increased sales, including increased labor costs and, to a lesser extent, increased variable costs associated with our cloud operations and an increase in labor costs related to UltiPro managed services.
- The increase in Customer Support costs for the year ended December 31, 2015 was primarily due to higher labor costs commensurate with the growth in the number of cloud customers serviced.

Cost of services revenues increased 16.3% to \$99.9 million for 2015 from \$85.9 million for 2014. The \$14.0 million increase in cost of services revenues was primarily due to an increase in the cost of implementation, including higher labor and related costs, particularly in association with the increased number of implementation consultants and, to a lesser extent, the increased use of third-party implementation partners.

### *Sales and Marketing*

Sales and marketing expenses consist primarily of salaries and benefits, sales commissions, travel and promotional expenses, and facility and communication costs for direct sales offices, as well as advertising and marketing costs. Sales and marketing expenses increased 45.0% to \$169.7 million for 2015 from \$117.0 million for 2014. The \$52.7 million increase in sales and marketing during 2015 was primarily due to increased labor and related costs (including the impact of an increase in sales personnel, primarily in our mid-market and strategic sales channels, and higher sales commissions) and higher advertising and marketing expenses, which included media advertising, particularly in the fourth quarter of 2015. Included in the increased labor and related costs for the 2015 year was a portion of certain non-cash, stock-based compensation expenses relating to the CIC Plan Revisions. Commissions on subscription-based cloud sales are amortized over the initial contract term (typically 24 to 36 months) typically commencing on the Live date, which corresponds with the related cloud revenue recognition.

### *Research and Development*

Research and development expenses consist primarily of software development personnel costs. Research and development expenses increased 12.1% to \$93.7 million in 2015 from \$83.5 million in 2014. The \$10.2 million increase in research and development expenses during 2015 was principally due to higher labor and related costs associated with the ongoing development of UltiPro and Optional Capabilities, including the impact of increased personnel costs (predominantly from additional headcount), net of capitalized labor costs. For the years ended December 31, 2015 and 2014, we capitalized \$26.3 million (including \$3.0 million in non-cash stock-based compensation) and \$25.2 million (including \$1.7 million in non-cash stock-based compensation), respectively, of computer software development costs related to an internal-use development project for our UltiPro product offering (the "Development Project"). The capitalized costs for the Development Project were primarily from direct labor costs for the 2015 year. The capitalized costs for the Development Project were from direct labor costs and third party consulting fees for the 2014 year. For 2015 and 2014, we recognized \$1.1 million and \$0.7 million, respectively, of amortization costs which were associated with a particular product module, UltiPro Recruiting, of the Development Project which was ready for its intended use during the second quarter of 2014. The amortization of capitalized software is included in cost of recurring revenues.

### *General and Administrative*

General and administrative expenses consist primarily of salaries and benefits of executive, administrative and financial personnel, as well as external professional fees and the provision for doubtful accounts. General and administrative expenses increased by 53.9% to \$72.9 million for 2015 from \$47.4 million for 2014. The \$25.5 million increase in general and administrative expenses during 2015 was primarily due to higher labor and related costs, including increased personnel to support Ultimate's growth in operations, an increase in rent from additional leased space to accommodate our growth, an increase in the provision for doubtful accounts and the CIC Plan Revisions.

### *Provision for Income Taxes*

In 2015, based on pre-tax income, we had income tax expense of \$20.4 million as compared to \$9.6 million in 2014. The increase in income tax expense of \$10.8 million was primarily due to the excess of the benefit recorded in 2014 for research and development activities of \$14.4 million related to the tax years 1998-2014 over the benefit recorded in 2015 of \$3.2 million, primarily related to the tax year 2015. A decrease in pre-tax book income and an increase in non-deductible expenses also effected the year over year income tax expense. Ultimate recorded \$13.2 million and \$2.3 million of research and development tax credit carryforwards during the quarters ended September 30, 2014 and December 31, 2014, respectively. Ultimate recorded \$0.6 million and \$2.6 million of research and development tax credit carryforwards during the quarters ended September 30, 2015 and December 31, 2015, respectively.

### ***Quarterly Results of Operations***

The following table sets forth certain unaudited quarterly results of operations for each of the quarters in the years ended December 31, 2016 and 2015. In management's opinion, this unaudited information has been prepared on the same basis as the audited consolidated financial statements and includes all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information for the quarters presented. This information should be read in conjunction with Ultimate's Consolidated Financial Statements and Notes thereto included elsewhere in this Form 10-K.

Our quarterly revenues and operating results have varied significantly in the past and are likely to vary substantially from quarter to quarter in the future. Our operating results may fluctuate as a result of a number of factors, including, but not limited to, increased expenses (especially as they relate to product development, sales and marketing and the use of third-party consultants), timing of product releases, increased competition, variations in the mix of revenues, announcements of new products by us or our competitors and capital spending patterns of our customers. We establish our expenditure levels based upon our expectations as to future revenues, and, if revenue levels are below expectations, expenses can be disproportionately high. A drop in near term demand for our products could significantly affect both revenues and profits in any quarter. Operating results achieved in previous fiscal quarters are not necessarily indicative of operating results for the full fiscal years or for any future periods. As a result of these factors, there can be no assurance that we will be able to achieve or maintain profitability on a quarterly basis. We believe that, due to the underlying factors for quarterly fluctuations, quarter-to-quarter comparisons of Ultimate's operations are not necessarily meaningful and that such comparisons should not be relied upon as indications of future performance.

Quarters Ended	Dec 31, 2016	Sep 30, 2016	Jun 30, 2016	Mar 31, 2016	Dec 31, 2015	Sep 30, 2015	Jun 30, 2015	Mar 31, 2015
<b>(In thousands, except per share data)</b>								
<b>(Unaudited)</b>								
Revenues:								
Recurring .....	\$ 175,944	\$ 167,025	\$ 158,479	\$ 152,751	141,116	131,768	124,407	119,109
Services .....	34,605	29,966	28,058	34,463	29,534	23,556	22,823	25,768
Total revenues .....	<u>210,549</u>	<u>196,991</u>	<u>186,537</u>	<u>187,214</u>	<u>170,650</u>	<u>155,324</u>	<u>147,230</u>	<u>144,877</u>
Cost of revenues:								
Recurring .....	46,173	44,095	42,951	39,457	36,554	34,856	34,388	32,789
Services .....	33,218	32,069	29,342	32,804	26,982	25,027	23,621	24,318
Total cost of revenues .....	<u>79,391</u>	<u>76,164</u>	<u>72,293</u>	<u>72,261</u>	<u>63,536</u>	<u>59,883</u>	<u>58,009</u>	<u>57,107</u>
Gross profit .....	<u>131,158</u>	<u>120,827</u>	<u>114,244</u>	<u>114,953</u>	<u>107,114</u>	<u>95,441</u>	<u>89,221</u>	<u>87,770</u>
Operating expenses:								
Sales and marketing .....	58,074	55,212	54,548	56,582	48,019	41,687	39,195	40,763
Research and development .....	32,383	31,699	29,053	27,515	25,340	23,027	23,906	21,398
General and administrative .....	25,439	25,284	22,180	21,529	19,433	19,120	18,488	15,852
Total operating expenses .....	<u>115,896</u>	<u>112,195</u>	<u>105,781</u>	<u>105,626</u>	<u>92,792</u>	<u>83,834</u>	<u>81,589</u>	<u>78,013</u>
Operating income .....	<u>15,262</u>	<u>8,632</u>	<u>8,463</u>	<u>9,327</u>	<u>14,322</u>	<u>11,607</u>	<u>7,632</u>	<u>9,757</u>
Other (expense) income:								
Interest expense and other, net .....	(174)	(179)	(180)	(184)	(123)	(118)	(135)	(115)
Other income, net .....	135	111	102	103	91	62	46	57
Total other expense, net .....	<u>(39)</u>	<u>(68)</u>	<u>(78)</u>	<u>(81)</u>	<u>(32)</u>	<u>(56)</u>	<u>(89)</u>	<u>(58)</u>
Income before income taxes .....	<u>15,223</u>	<u>8,564</u>	<u>8,385</u>	<u>9,246</u>	<u>14,290</u>	<u>11,551</u>	<u>7,543</u>	<u>9,699</u>
Provision for income taxes .....	(2,452)	(3,801)	(2,264)	(2,648)	(5,259)	(5,700)	(3,886)	(5,539)
Net income .....	<u>\$ 12,771</u>	<u>\$ 4,763</u>	<u>\$ 6,121</u>	<u>\$ 6,598</u>	<u>\$ 9,031</u>	<u>\$ 5,851</u>	<u>\$ 3,657</u>	<u>\$ 4,160</u>
Earnings per share:								
Basic .....	<u>\$ 0.44</u>	<u>\$ 0.16</u>	<u>\$ 0.21</u>	<u>\$ 0.23</u>	<u>\$ 0.31</u>	<u>\$ 0.20</u>	<u>\$ 0.13</u>	<u>\$ 0.15</u>
Diluted .....	<u>\$ 0.42</u>	<u>\$ 0.16</u>	<u>\$ 0.20</u>	<u>\$ 0.22</u>	<u>\$ 0.30</u>	<u>\$ 0.20</u>	<u>\$ 0.12</u>	<u>\$ 0.14</u>
Weighted average shares outstanding:....								
Basic .....	<u>29,200</u>	<u>28,977</u>	<u>28,895</u>	<u>28,825</u>	<u>28,756</u>	<u>28,603</u>	<u>28,591</u>	<u>28,583</u>
Diluted .....	<u>30,469</u>	<u>30,475</u>	<u>30,240</u>	<u>30,108</u>	<u>29,873</u>	<u>29,715</u>	<u>29,591</u>	<u>29,567</u>

### Seasonality

We have experienced, and may experience in the future, seasonality in our business, and our business, operating results and financial condition may be affected by such trends in the future. Ultimate's quarterly revenues and operating results have varied significantly in the past and are likely to vary substantially from quarter to quarter in the future. Revenues have historically increased at higher rates in the fourth quarter of the year and at lower rates in the next succeeding quarter. We believe such seasonality is due to a number of factors, including our quota-based compensation arrangements, typical of those used in software companies, and year-end budgetary pressures on our customers. We believe that the seasonal trend that Ultimate has experienced in the past may continue in the foreseeable future.

## Liquidity and Capital Resources

In recent years, we have funded operations primarily from cash flows generated from operations.

As of December 31, 2016, we had \$97.9 million in cash, cash equivalents and corporate investments in marketable securities, reflecting a net decrease of \$31.5 million since December 31, 2015. The decrease in cash and cash equivalents for the year was primarily from cash used for the repurchases of shares of Common Stock under our previously announced stock repurchase plan ("Stock Repurchase Plan") of \$29.7 million, \$65.5 million of cash used to settle the employee tax withholding liability for vesting of restricted stock awards and restricted stock units, cash purchases of property and equipment (including principal payments on financed equipment) of \$75.2 million (which includes \$34.0 million of capitalized labor and third party consulting costs, paid in cash, associated with the Development Project), \$9.1 million of cash used for the Vestrics Acquisition and \$16.9 million of cash used for the Kanjoya Acquisition, partially offset by cash provided by operations of \$159.5 million and proceeds from the issuances of Common Stock from employee and non-employee director stock option exercises of \$4.7 million.

As part of our early adoption of ASU 2016-09 during the third quarter of fiscal year 2016, we recognized excess tax benefits in our provision for income taxes rather than additional paid-in capital for all periods in fiscal year 2016. We elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively to all periods presented which resulted in an increase to both net cash from operations and net cash used in financing of \$31.9 million for the year ended December 31, 2015. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to any of the periods presented in our consolidated cash flows statements since such cash flows have historically been presented as a financing activity.

Our operating cash inflows primarily consist of payments received from our UltiPro customers. Our operating cash outflows primarily consist of cash we invest in personnel and infrastructure to support the anticipated growth of our business, payments to vendors related to our services, payments under arrangements with third party vendors who provide hosting infrastructure services in connection with UltiPro, related sales and marketing costs, costs of operations and systems development and programming costs. Net cash provided by operating activities increased \$16.8 million during 2016 as compared with 2015. This increase was primarily due to an increase in operating income (after adjusting for the impact of non-cash expenses) of \$33.1 million, partially offset by cash paid for working capital, including prepaid commissions (short- and long-term) in association with increased sales.

Net cash provided by investing activities was \$358.2 million for 2016 as compared with net cash used in investing activities of \$224.8 million for 2015. The \$583.0 million increase from 2015 was primarily attributable to an increase of \$631.4 million in client funds received from our customers using the UltiPro payment services offering ("UltiPro Payment Services") and an increase in maturities of marketable securities of \$112.2 million, partially offset by an increase in the purchases of marketable securities of \$116.1 million (which includes \$148.8 million of funds held for customers being invested in marketable securities in addition to our corporate funds), and an increase in cash purchases of property and equipment of \$17.8 million (including an increase of \$10.7 million of capitalized labor costs and, to a lesser extent, third party consulting costs, paid in cash, associated with the Development Project). We invest our customer funds in available for sale securities in addition to our corporate funds in accordance with our internal investment strategies. The portfolio predominantly consists of investment grade securities with long-term ratings of AAA and AA+ and short-term ratings A-1/P-1. Customer funds not invested in available for sale securities, temporarily held by us as a result of our UltiPro Payment Services, are invested in U.S. Government money market funds that invest in short-term, high quality money market instruments which consist of U.S. Treasury and U.S. Government Agency obligations and repurchase agreements collateralized by such obligations. The money market funds are rated AAA by Standard & Poor's and Aaa by Moody's. Any residual customer funds are held primarily in our bank accounts.

Net cash used in financing activities was \$553.7 million for 2016 as compared with net cash provided by financing activities of \$85.5 million for 2015. The \$639.2 million increase in net cash used in financing activities was primarily related to an increase of \$621.2 million in UltiPro Payment Services client fund obligations, an increase of \$30.5 million in cash used to settle employee tax withholding liabilities for the vesting of restricted stock, partially offset by, a \$13.5 million decrease in cash used for the repurchases of shares of Common Stock under our Stock Repurchase Plan.

Days sales outstanding ("DSO"), calculated on a trailing three-month basis, as of December 31, 2016 were 71 days as compared with 70 days as of December 31, 2015. The increase of one day was associated with stronger sales bookings at the end of 2016.

Deferred revenues were \$174.0 million at December 31, 2016, as compared with \$145.7 million at December 31, 2015. The increase of \$36.0 million in deferred revenues for 2016 was primarily due to higher deferred cloud revenues mainly attributable to increased sales.

We believe that cash and cash equivalents, investments in marketable securities, equipment financing, other borrowings and cash generated from operations will be sufficient to fund our operations for at least the next 12 months. This belief is based upon, among other factors, management's expectations for future revenue growth, controlled expenses and collections of accounts receivable.

As of December 31, 2016, we did not have any material commitments for capital expenditures, except for anticipated capitalized costs associated with the Development Project.

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

We do not, and, as of December 31, 2016, we did not, have any off-balance sheet arrangements (as that term is defined in applicable SEC rules) that are reasonably likely to have a current or future material effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources.

### **Non-GAAP Financial Measures**

Item 10 (e) of Regulation S-K, "Use of Non-GAAP Financial Measures in Commission Filings," defines and prescribes the use of non-GAAP financial information. Our measure of Non-GAAP Operating Income, which excludes non-cash stock-based compensation, amortization of acquired intangibles, and transaction costs related to business combinations meets the definition of a non-GAAP financial measure.

Ultimate believes that this non-GAAP measure of financial results provides useful information to management and investors regarding certain financial and business trends relating to Ultimate's financial condition and results of operations. Ultimate's management uses this non-GAAP result to compare Ultimate's performance to that of prior periods for trend analyses, for purposes of determining executive incentive compensation, and for budget and planning purposes. This measure is used in monthly financial reports prepared for management and in quarterly financial reports presented to Ultimate's Board of Directors. This measure may be different from non-GAAP financial measures used by other companies.

This non-GAAP measure should not be considered in isolation or as an alternative to such measures determined in accordance with generally accepted accounting principles in the United States (GAAP). The principal limitation of this non-GAAP financial measure is that it excludes significant expenses that are required by GAAP to be recorded. In addition, it is subject to inherent limitations as it reflects the exercise of judgment by management about which expenses are excluded from the non-GAAP financial measure.

To compensate for these limitations, Ultimate presents its non-GAAP financial measure in connection with its GAAP result. Ultimate strongly urges investors and potential investors in Ultimate's securities to review the reconciliation of its non-GAAP financial measure to the comparable GAAP financial measure that is included in the table below and not to rely on any single financial measure to evaluate its business.

We exclude the following items from the non-GAAP financial measure, Non-GAAP Operating Income, as appropriate:

*Stock-based compensation expense.* Ultimate's non-GAAP financial measure of Non-GAAP Operating Income excludes non-cash stock-based compensation expense, which consists of expenses for restricted stock and stock unit awards recorded in accordance with Accounting Standards Codification 718, "Compensation - Stock Compensation." For the years ended December 31, 2016, 2015 and 2014, stock-based compensation expense was \$113.9 million, \$82.4 million and \$46.2 million, respectively, on a pre-tax basis. Stock-based compensation expense is excluded from the non-GAAP financial measures because it is a non-cash expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates the comparison of results of ongoing operations for current and future periods with such results from past periods. For GAAP net income periods, non-GAAP reconciliations are calculated on a diluted weighted average share basis.

*Amortization of acquired intangible assets.* In accordance with GAAP, operating expenses include amortization of acquired intangible assets over the estimated useful lives of such assets. For the years ended December 31, 2016, 2015 and 2014, the amortization of acquired intangible assets was \$1.1 million, \$1.0 million and \$1.1 million, respectively. Amortization of acquired intangible assets is excluded from Ultimate's non-GAAP financial measures because it is a non-cash expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates comparisons to its historical operating results and to the results of other companies in the same industry, which have their own unique acquisition histories.

*Transaction costs related to business combinations.* In accordance with GAAP, operating expenses include transaction costs for third-party professional services incurred in connection with business combinations. As we do not acquire or dispose

of businesses on a predictable basis, the terms of each business combination are unique and can vary significantly from other business combinations. Significant expenses can be incurred in connection with a business combination that we would not have otherwise incurred in the periods presented as part of our continuing operations. For the year ended December 31, 2016 the transactions costs incurred related to business combinations were \$0.9 million. There were no transaction costs incurred related to business combinations for the years ended December 31, 2015 and 2014. Transaction costs related to business combinations are excluded from Ultimate's non-GAAP financial measures because it is an expense that Ultimate does not consider part of ongoing operations when assessing its financial performance. Ultimate believes that such exclusion facilitates comparisons to its historical operating results and to the results of other companies in the same industry, which have their own unique business combination histories.

	<b>For the Year Ended</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Non-GAAP operating income reconciliation:</b>			
Operating income .....	\$ 41,684	\$ 43,318	\$ 54,343
<i>Operating income, as a % of total revenues</i> .....	5.3%	7.0%	10.7%
Add back:			
Non-cash stock-based compensation expense.....	113,877	82,416	46,185
Non-cash amortization of acquired intangible assets.....	1,115	1,034	1,142
Transaction costs related to business combinations.....	874	—	—
Non-GAAP operating income .....	<u>\$ 157,550</u>	<u>\$ 126,768</u>	<u>\$ 101,670</u>
<i>Non-GAAP operating income, as a % of total revenues</i> ....	<u>20.2%</u>	<u>20.5%</u>	<u>20.1%</u>

### Contractual Obligations

As of December 31, 2016, Ultimate's outstanding contractual cash obligations were as follows (in thousands):

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>More than 5 Years</b>
Capital lease obligations (1).....	\$ 9,041	\$ 5,056	\$ 3,985	\$ —	\$ —
Other long-term obligations (2) .....	60,369	14,425	22,046	19,175	4,723
Other long-term liabilities (3) .....	7,241	7,241	—	—	—
Total contractual cash obligations.....	<u>\$ 76,651</u>	<u>\$ 26,722</u>	<u>\$ 26,031</u>	<u>\$ 19,175</u>	<u>\$ 4,723</u>

- (1) We lease certain computer equipment under non-cancelable agreements, which are accounted for as capital leases and expire at various dates through 2019. See Note 13 of the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K for information regarding capital lease obligations.
- (2) Included in other long-term obligations were Ultimate's leases for corporate office space and certain equipment under non-cancelable operating lease agreements expiring at various dates.
- (3) Ultimate has an income tax payable related to the unrecognizable benefit of an uncertain tax position. As of the date of this report, it is not reasonable to estimate the timing of this payment. Ultimate does not have any other long-term liabilities as of December 31, 2016.

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

In the ordinary course of Ultimate's operations, we are exposed to certain market risks, primarily interest rate risk and foreign currency risk. Risks that are either non-financial or non-quantifiable, such as political, economic, tax, or regulatory risks, are not included in the following assessment of our market risks.

*Interest Rate Risk.* Ultimate is subject to financial market risks, including changes in interest rates which influence the valuations of our fixed income investment portfolio. Changes in interest rates could also impact Ultimate's anticipated interest income from interest-bearing cash accounts, or cash equivalents and investments in marketable securities. We manage financial market risks, including interest rate risks, in accordance with our investment guideline objectives, including:

- Maximum safety of principal;
- Maintenance of appropriate liquidity for regular cash needs;

- Maximum yields in relationship to guidelines and market conditions;
- Diversification of risks; and
- Fiduciary control of all investments.

Ultimate targets its fixed income investment portfolio to have maturities of 24 months or less. Investments are held to enhance the preservation of capital and not for trading purposes.

Cash equivalents consist of money market accounts with original maturities of less than three months. Short-term investments include obligations of U.S. government agencies, asset-backed securities and corporate debt securities. Corporate debt securities include commercial paper which, according to Ultimate's investment guidelines, must carry minimum short-term ratings of P-1 by Moody's Investor Service, Inc. ("Moody's") and A-1 by Standard & Poor's Ratings Service, a Division of The McGraw-Hill Companies, Inc. ("S&P"). Other corporate debt obligations must carry a minimum rating of A-2 by Moody's or A by S&P. Asset-backed securities must carry a minimum AAA rating by Moody's and S&P with a maximum average life of two years at the time of purchase.

As of December 31, 2016, total corporate investments in available-for-sale marketable securities were \$24.1 million. As of December 31, 2016, total investments with customer funds in available-for-sale marketable securities were \$148.8 million.

As of December 31, 2016, virtually all of the investments in Ultimate's corporate portfolio and portfolio of investments with customer funds were at fixed rates (with a weighted average interest rate of 1.1% and 0.8% per annum, respectively).

To illustrate the potential impact of changes in interest rates, Ultimate has performed an analysis based on its December 31, 2016 consolidated balance sheet and assuming no changes in its investments. Under this analysis, an immediate and sustained 100 basis point increase in the various base rates would result in a decrease in the fair value of Ultimate's corporate portfolio of approximately \$169 thousand over the next 12 months and a decrease in the fair value of Ultimate's portfolio of investments with customer funds of approximately \$941 thousand over the next 12 months. An immediate and sustained 100 basis point decrease in the various base rates would result in an increase in the fair value of Ultimate's corporate portfolio of approximately \$162 thousand over the next 12 months and an increase in the fair value of Ultimate's portfolio of investments with customer funds of approximately \$810 thousand over the next 12 months.

*Foreign Currency Risk.* Ultimate has foreign currency risks related to its revenue and operating expenses denominated in currencies other than the U.S. dollar. Management does not believe movements in the foreign currencies in which Ultimate transacts business will materially affect future net income.

**Item 8. Financial Statements and Supplementary Data**

**INDEX**

	<b>Page(s)</b>
Report of Independent Registered Public Accounting Firm .....	45
Consolidated Balance Sheets as of December 31, 2016 and 2015 .....	46
Consolidated Statements of Income for the Years Ended December 31, 2016, 2015 and 2014.....	47
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016, 2015 and 2014..	48
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2016, 2015 and 2014 .....	49
Consolidated Statements of Cash Flows for the Years Ended December 31, 2016, 2015 and 2014 .....	51
Notes to Consolidated Financial Statements.....	53



## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
The Ultimate Software Group, Inc.:

We have audited the accompanying consolidated balance sheets of The Ultimate Software Group, Inc. and subsidiaries (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), The Ultimate Software Group, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2017 expressed an unqualified opinion on the effectiveness of The Ultimate Software Group, Inc.'s internal control over financial reporting.

/s/ KPMG LLP

February 24, 2017  
Fort Lauderdale, Florida  
Certified Public Accountants

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	As of December 31,	
	2016	2015
	(In thousands, except share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents.....	\$ 73,773	\$ 109,325
Investments in marketable securities .....	15,541	10,780
Accounts receivable, net of allowance for doubtful accounts of \$900 for 2016 and 2015.....	162,240	130,106
Prepaid expenses and other current assets .....	61,901	46,804
Deferred tax assets, net .....	1,125	883
Total current assets before funds held for customers .....	314,580	297,898
Funds held for customers .....	465,167	923,308
Total current assets .....	779,747	1,221,206
Property and equipment, net.....	179,558	125,492
Goodwill.....	35,322	24,410
Investments in marketable securities.....	8,547	9,278
Intangible assets, net .....	23,860	5,167
Other assets, net.....	47,432	31,107
Deferred tax assets, net.....	78,115	48,909
Total assets .....	\$ 1,152,581	\$ 1,465,569
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 13,519	\$ 7,395
Accrued expenses.....	50,973	42,097
Deferred revenue .....	171,669	142,793
Capital lease obligations .....	5,056	4,488
Other borrowings .....	—	400
Total current liabilities before customer funds obligations .....	241,217	197,173
Customer funds obligations .....	466,423	923,366
Total current liabilities .....	707,640	1,120,539
Deferred revenue .....	2,307	2,934
Deferred rent .....	6,022	3,719
Capital lease obligations.....	3,985	3,665
Deferred income tax liability.....	519	646
Total liabilities .....	720,473	1,131,503
Commitments and contingencies (Note 16).....	—	—
Stockholders' equity:		
Series A Junior Participating Preferred Stock, \$.01 par value, 500,000 shares authorized, no shares issued.....	—	—
Preferred Stock, \$.01 par value, 2,000,000 shares authorized, no shares issued .....	—	—
Common Stock, \$.01 par value, 50,000,000 shares authorized, 34,003,036 and 33,260,879 shares issued in 2016 and 2015, respectively.....	340	333
Additional paid-in capital .....	520,524	463,609
Accumulated other comprehensive loss.....	(7,023)	(7,829)
Accumulated earnings.....	129,626	59,627
Total stockholders' equity .....	643,467	515,740
Treasury stock, 4,657,995 and 4,467,595 shares, at cost, for 2016 and 2015, respectively .....	(211,359)	(181,674)
Total stockholders' equity .....	432,108	334,066
Total liabilities and stockholders' equity .....	\$ 1,152,581	\$ 1,465,569

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	(in thousands, except per share data)		
Revenues:			
Recurring.....	\$ 654,199	\$ 516,400	\$ 419,771
Services .....	127,092	101,681	86,165
Total revenues .....	781,291	618,081	505,936
Cost of revenues:			
Recurring.....	172,676	138,587	117,700
Services .....	127,433	99,948	85,939
Total cost of revenues .....	300,109	238,535	203,639
Gross profit .....	481,182	379,546	302,297
Operating expenses:			
Sales and marketing .....	224,416	169,664	117,033
Research and development.....	120,650	93,671	83,542
General and administrative .....	94,432	72,893	47,379
Total operating expenses.....	439,498	336,228	247,954
Operating income .....	41,684	43,318	54,343
Other (expense) income:			
Interest expense and other, net .....	(717)	(491)	(353)
Other income, net.....	451	256	339
Total other expense, net .....	(266)	(235)	(14)
Income before income taxes .....	41,418	43,083	54,329
Provision for income taxes.....	(11,165)	(20,384)	(9,592)
Net income .....	\$ 30,253	\$ 22,699	\$ 44,737
Net income per share:			
Basic .....	\$ 1.04	\$ 0.79	\$ 1.58
Diluted .....	\$ 0.99	\$ 0.76	\$ 1.52
Weighted average shares outstanding:			
Basic .....	28,976	28,634	28,293
Diluted .....	30,414	29,721	29,343

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income .....	\$ 30,253	\$ 22,699	\$ 44,737
Other comprehensive (loss) income:			
Unrealized loss on investments in marketable available for sale securities .	(61)	(56)	(10)
Unrealized gain (loss) on foreign currency translation adjustments .....	843	(4,195)	(2,143)
Other comprehensive income (loss), before tax.....	782	(4,251)	(2,153)
Income tax benefit related to items of other comprehensive income .....	24	12	1
Other comprehensive income (loss), net of tax.....	\$ 806	\$ (4,239)	\$ (2,152)
Comprehensive income.....	\$ 31,059	\$ 18,460	\$ 42,585

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated (Deficit) Earnings	Treasury Stock		Total Stockholders' Equity
	Shares	Amount				Shares	Amount	
<b>Balance, December 31, 2013</b> .....	<b>32,133</b>	<b>\$ 321</b>	<b>\$ 315,691</b>	<b>\$ (1,442)</b>	<b>\$ (7,809)</b>	<b>4,054</b>	<b>\$ (118,544)</b>	<b>\$ 188,217</b>
Net income.....	—	—	—	—	44,737	—	—	44,737
Unrealized gain on investments in marketable securities available-for-sale, net of tax .....	—	—	—	(5)	—	—	—	(5)
Unrealized loss on foreign exchange .....	—	—	—	(2,143)	—	—	—	(2,143)
Shares acquired to settle employee tax withholding liability .....	—	—	(19,883)	—	—	—	—	(19,883)
Excess tax benefits from employee stock plan .....	—	—	27,499	—	—	—	—	27,499
Repurchases of Common Stock .....	—	—	—	—	—	163	(19,981)	(19,981)
Stock consideration for acquisitions .....	13	—	(818)	—	—	—	—	(818)
Issuances of Common Stock from exercises of stock options.....	310	3	6,205	—	—	—	—	6,208
Issuances of Common Stock from restricted stock releases .....	267	3	—	—	—	—	—	3
Non-cash stock-based compensation expense ...	—	—	47,915	—	—	—	—	47,915
<b>Balance, December 31, 2014</b> .....	<b>32,723</b>	<b>\$ 327</b>	<b>\$ 376,609</b>	<b>\$ (3,590)</b>	<b>\$ 36,928</b>	<b>4,217</b>	<b>\$ (138,525)</b>	<b>\$ 271,749</b>
Net income.....	—	—	—	—	22,699	—	—	22,699
Unrealized loss on investments in marketable securities available-for-sale, net of tax .....	—	—	—	(44)	—	—	—	(44)
Unrealized loss on foreign exchange .....	—	—	—	(4,195)	—	—	—	(4,195)
Shares acquired to settle employee tax withholding liability .....	—	—	(34,989)	—	—	—	—	(34,989)
Excess tax benefits from employee stock plan .....	—	—	31,859	—	—	—	—	31,859
Repurchases of Common Stock .....	—	—	—	—	—	251	(43,149)	(43,149)
Stock consideration for acquisitions .....	13	1	—	—	—	—	—	1
Issuances of Common Stock from exercises of stock options.....	189	2	4,701	—	—	—	—	4,703
Issuances of Common Stock from restricted stock releases .....	336	3	—	—	—	—	—	3
Non-cash stock-based compensation expense ...	—	—	85,429	—	—	—	—	85,429
<b>Balance, December 31, 2015</b> .....	<b>33,261</b>	<b>\$ 333</b>	<b>\$ 463,609</b>	<b>\$ (7,829)</b>	<b>\$ 59,627</b>	<b>4,468</b>	<b>\$ (181,674)</b>	<b>\$ 334,066</b>

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Accumulated (Deficit) Earnings	Treasury Stock		Total Stockholders' Equity
	Shares	Amount				Shares	Amount	
Cumulative impact of adoption of ASU 2016-09 .....	—	—	—	—	39,746	—	—	39,746
Net income.....	—	—	—	—	30,253	—	—	30,253
Unrealized loss on investments in marketable securities available-for-sale, net of tax .....	—	—	—	(37)	—	—	—	(37)
Unrealized loss on foreign exchange .....	—	—	—	843	—	—	—	843
Shares acquired to settle employee tax withholding liability .....	—	—	(65,522)	—	—	—	—	(65,522)
Repurchases of Common Stock .....	—	—	—	—	—	190	(29,685)	(29,685)
Stock consideration for acquisitions .....	7	—	—	—	—	—	—	—
Issuances of Common Stock from exercises of stock options .....	183	2	4,657	—	—	—	—	4,659
Issuances of Common Stock from restricted stock releases .....	552	5	—	—	—	—	—	5
Non-cash stock-based compensation expense ...	—	—	117,780	—	—	—	—	117,780
<b>Balance, December 31, 2016 .....</b>	<b>34,003</b>	<b>\$ 340</b>	<b>\$ 520,524</b>	<b>\$ (7,023)</b>	<b>\$ 129,626</b>	<b>4,658</b>	<b>\$ (211,359)</b>	<b>\$ 432,108</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.

**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	(in thousands)		
Cash flows from operating activities:			
Net income .....	\$ 30,253	\$ 22,699	\$ 44,737
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization.....	27,098	21,738	19,263
Provision for doubtful accounts.....	3,213	4,687	2,264
Non-cash stock-based compensation expense.....	113,877	82,416	46,185
Income taxes.....	10,195	19,739	9,030
Net amortization of premiums and accretion of discounts on available-for-sale securities.....	755	—	—
Changes in operating assets and liabilities:			
Accounts receivable.....	(35,004)	(34,575)	(16,806)
Prepaid expenses and other current assets.....	(14,973)	(12,016)	(5,414)
Other assets.....	(16,325)	(10,496)	(3,271)
Accounts payable.....	5,850	(23)	996
Accrued expenses and deferred rent.....	7,403	12,507	4,582
Deferred revenue.....	27,179	36,022	6,521
Net cash provided by operating activities.....	<u>159,521</u>	<u>142,698</u>	<u>108,087</u>
Cash flows from investing activities:			
Purchases of marketable securities.....	(207,676)	(91,528)	(10,355)
Maturities of marketable securities.....	123,895	11,711	10,377
Payments for acquisitions.....	(25,636)	—	(257)
Net change in money market securities and other cash equivalents held to satisfy client fund obligations.....	537,077	(94,306)	(496,860)
Purchases of property and equipment, including capitalized software development.....	(69,415)	(50,634)	(38,100)
Net cash provided by (used in) investing activities.....	<u>358,245</u>	<u>(224,757)</u>	<u>(535,195)</u>
Cash flows from financing activities:			
Repurchases of Common Stock.....	(29,685)	(43,149)	(19,981)
Net proceeds from issuances of Common Stock.....	4,659	4,703	6,208
Shares acquired to settle employee tax withholding liabilities.....	(65,522)	(34,989)	(19,883)
Principal payments on capital lease obligations.....	(5,831)	(4,810)	(4,082)
Repayments of other borrowings.....	(400)	(567)	(2,690)
Net (decrease) increase in customer fund obligations.....	(456,943)	164,279	496,860
Net cash (used in) provided by financing activities.....	<u>(553,722)</u>	<u>85,467</u>	<u>456,432</u>
Effect of exchange rate changes on cash.....	404	(2,381)	(820)
Net (decrease) increase in cash and cash equivalents.....	(35,552)	1,027	28,504
Cash and cash equivalents, beginning of year.....	109,325	108,298	79,794
Cash and cash equivalents, end of year.....	<u>\$ 73,773</u>	<u>\$ 109,325</u>	<u>\$ 108,298</u>

Supplemental disclosure of cash flow information:

Cash paid for interest.....	\$	426	\$	371	\$	327
Cash paid for taxes.....	\$	1,758	\$	815	\$	582

Non-cash investing and financing activities:

Capital lease obligations to acquire new equipment.....	\$	6,719	\$	5,949	\$	5,907
Stock consideration adjustment recorded for acquisitions .....	\$	—	\$	—	\$	(818)
Cash held in escrow for business combinations .....	\$	3,600	\$	—	\$	—
License agreement with third-party vendor, financed .....	\$	—	\$	—	\$	800
Stock based compensation for capitalized software .....	\$	3,903	\$	3,013	\$	1,730

The accompanying Notes to Consolidated Financial Statements are an integral part of these financial statements.



**THE ULTIMATE SOFTWARE GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Nature of Operations**

The Ultimate Software Group, Inc. and subsidiaries (“Ultimate,” “we,” “us” or “our”) is a leading cloud provider of people management solutions, often referred to as human capital management (“HCM”). Ultimate’s UltiPro product suite (“UltiPro”) is a comprehensive, engaging solution that has human resources (“HR”), payroll, and benefits management at its core and includes global people management, available in twelve languages with more than 35 country-specific localizations. The solution is delivered via software-as-a-service to organizations based in the United States and Canada, including those with global workforces. UltiPro is designed to deliver the functionality businesses need to manage the complete employment life cycle from recruitment to retirement. We market our UltiPro solutions primarily to enterprise companies, which we define as organizations with 2,501 or more employees, including those with 10,000 or more employees; mid-market companies, which we define as those having 501-2,500 employees; and strategic market companies, which we define as those having 100-500 employees. UltiPro is marketed primarily through our enterprise, mid-market and strategic direct sales teams.

**2. Basis of Presentation, Consolidation and the Use of Estimates**

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

The consolidated financial statements included herein reflect all adjustments, which are, in the opinion of Ultimate’s management, necessary for a fair presentation of the information for the periods presented. The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, revenue recognition, income taxes, the allowance for doubtful accounts, the valuation of deferred tax assets and long-lived assets, among others discussed below. Actual results could differ from those estimates.

The consolidated financial statements reflect the financial position and operating results of Ultimate and include its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

**3. Summary of Significant Accounting Policies and Recent Accounting Pronouncements**

**Cash and Cash Equivalents**

All highly liquid instruments with an original maturity of three months or less when acquired are considered cash equivalents and are comprised of interest-bearing accounts.

**Accounts Receivable**

Accounts receivable are principally from end-users of Ultimate’s products. We maintain an allowance for doubtful accounts at an amount estimated to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on accounts receivable. A considerable amount of judgment is required when the realization of receivables is assessed, including assessing the probability of collection and current credit-worthiness of each customer. If the financial condition of our customers were to deteriorate, resulting in a further impairment of their ability to make payments, an additional provision for doubtful accounts may be required. We charge off uncollectible amounts against the allowance for doubtful accounts in the period in which we determine they are uncollectible.

**Funds Held for Customers and Customers’ Funds Obligations**

Ultimate has the right to market and distribute an independent third party’s tax filing solution that Ultimate has branded UltiPro Payment Services. Ultimate’s UltiPro Payment Services offering provides payment services to our customers. These payment services are being sold directly by us to our customers only on a per-employee-per-month (“PEPM”) basis in conjunction with UltiPro, our core product. In connection with our UltiPro Payment Services product, we receive funds from our customers and hold such funds for purposes of paying the appropriate taxing authorities on behalf of such customers. We invest a portion of our customer funds in available for sale securities in addition to our corporate funds in accordance with our internal investment strategies. The portfolio predominantly consists of investment grade securities with long-term ratings of AAA and AA+ and short-term ratings A-1/P-1. These funds held for customers and the corresponding customer funds obligations are included in current assets and current liabilities, respectively, in our consolidated balance sheets as of December 31, 2016 and 2015. We have reported the cash flows for purchases of securities with funds received from

UltiPro Payment Services customers in the investing activities section of the consolidated statements of cash flows for the years ended December 31, 2016, 2015 and 2014. We have reported the cash flows related to the funds received and paid on behalf of such customers to the applicable taxing authorities in the financing activities section of the consolidated statements of cash flows for the years ended December 31, 2016, 2015 and 2014. The associated PEPM fees for UltiPro Payment Services are included in recurring revenues in the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014. The associated interest earned was not material for the years ended December 31, 2016, 2015 and 2014.

### **Fair Value of Financial Instruments**

Ultimate's financial instruments, consisting of cash and cash equivalents, investments in marketable securities, funds held for customers and the related obligations, accounts receivable, accounts payable, and capital lease obligations and other borrowings, approximated fair value (due to their relatively short maturity) as of December 31, 2016 and 2015.

### **Funds Held for Customers and Corporate Investments**

We classify our investments in marketable securities with readily determinable fair values as available-for-sale. Available-for-sale securities consist of debt and equity securities not classified as trading securities or as securities to be held to maturity. Unrealized gains and losses, net of tax, on available-for-sale securities are reported as a net amount in accumulated other comprehensive income in stockholders' equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. Interest earned on investments from funds held for customers is included in recurring revenue and was not material in the years presented. If the fair value of an available-for-sale debt security is below its amortized cost, Ultimate assesses whether we intend to sell the security or if it is more likely than not we will be required to sell the security before recovery. If either of those two conditions are met, Ultimate would recognize a charge in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If we do not intend to sell a security or it is not more likely than not that it will be required to sell the security before recovery, the unrealized loss is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in accumulated other comprehensive income.

### **Prepaid Expenses and Other Current Assets**

Ultimate's financial statements include prepaid expenses and other current assets which include prepaid commissions on cloud sales. Prepaid expenses are amortized over the life of the asset (typically within one year) and commissions on cloud sales are amortized over the initial contract term (typically 24-36 months) typically commencing on the day the customer processes its first live payroll using UltiPro (also referred to as going "Live"), which corresponds with the related cloud revenue recognition. The portion of prepaid commissions that extends beyond one year is classified in other assets, net, in the consolidated balance sheets as of December 31, 2016 and 2015.

### **Long-Lived Assets**

We evaluate the carrying value of long-lived assets when indicators of impairment exist. For the year ended December 31, 2016, no such events or circumstances were identified. The carrying value of a long-lived asset is considered impaired when the undiscounted expected future cash flows from such asset (or asset group) are separately identifiable and less than the asset's (or asset group's) carrying value. In that event, a loss is recognized to the extent that the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. For the years ended December 31, 2016, 2015 and 2014, we recorded no impairment of our long-lived assets.

### **Property and Equipment**

Property and equipment is stated at cost, net of accumulated depreciation and amortization. Property and equipment is depreciated using the straight-line method over the estimated useful lives of the assets, which range from 2 to 15 years. Leasehold improvements and assets under capital leases are amortized over the shorter of the life of the asset or the term of the lease over periods ranging from approximately 3 to 15 years. Maintenance and repairs are charged to expense when incurred; betterments are capitalized. Upon the sale or retirement of assets, the cost, accumulated depreciation and amortization are removed from the accounts and any gain or loss is recognized.

### **Computer Software Development Costs**

Computer software development costs related to software developed for internal use falls under the accounting guidance of ASC Topic 350-40, *Intangibles Goodwill and Other—Internal Use Software*, in which computer software costs are expensed as incurred during the preliminary project stage and capitalization begins in the application development stage once the capitalization criteria are met. Costs associated with post implementation activities are expensed as incurred. Costs

capitalized during the application development stage include external direct costs of materials and services consumed in developing or obtaining internal-use software and payroll and payroll-related costs for employees who are directly associated with, and who devote time to, the internal-use computer software. In addition to capitalizing costs for software (which are used by us in our general operations, for internal purposes), we also capitalize costs under ASC Topic 350-40 for certain software development projects related to our suite of products sold to our customers exclusively on a subscription basis under our software-as-a-service offering of UltiPro.

### **Deferred Revenue**

Deferred revenue is primarily comprised of deferrals for recurring revenues for cloud services which are recognized over the term of the related contract as the services are performed, typically 24-36 months and commencing with the related Live date; and implementation consulting services for which the services have not yet been rendered which are primarily recognized prior to the respective Live date.

### **Guarantees**

The standard commercial terms in our sales contracts for UltiPro include an indemnification clause that indemnifies the customer against certain liabilities and damages arising from any claims of patent, copyright, or other proprietary rights of any third party. Due to the nature of the intellectual property indemnification provided to our customers, we cannot estimate the fair value, or determine the total nominal amount, of the indemnification until such time as a claim for such indemnification is made. In the event of a claim made against us under such provision, we evaluate estimated losses for such indemnification considering such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, Ultimate has not had any claims made against it under such provision and, accordingly, has not accrued any liabilities related to such indemnifications in its consolidated financial statements.

### **Segment Information**

Public companies are required to report selected information about operating segments in annual and interim financial reports to shareholders, as well as related disclosures about an enterprise's business segments, products, services, geographic areas and major customers. Ultimate operates its business as a single segment and is comprised as a single reporting unit.

### **Revenue Recognition**

We recognize revenues in accordance with Accounting Standards Update No. 2009-13, "Multiple-Deliverable Revenue Arrangements" ("ASU 2009-13"). We use the relative selling price method to allocate the total consideration to units of accounting in a multiple element arrangement. We allocate revenue in an arrangement using the estimated selling price ("ESP") of deliverables if it does not have vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE") of selling price.

VSOE is the price charged when the same or similar product or service is sold separately. We define VSOE as a median price of recent stand-alone transactions that are priced within a narrow range.

TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. However, due to the difficulty in obtaining sufficient information on competitor pricing and differences in our product offerings when compared with those of our peers, we generally are unable to reliably determine TPE.

ESP is our best estimate of the selling price of an element in a transaction. If we are unable to establish selling price using either VSOE or TPE, we will use ESP in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact business if the product or service were sold by us on a stand-alone basis. Our determination of ESP involves the use of a customary discount from the list (or book) price for each element, with the discounted price applied within a narrow range. The customary discount is derived from historical data that has been analyzed to determine trends and patterns. We analyze the customary discount used for determining ESP on no less than an annual basis.

We evaluate each deliverable in our arrangements to determine whether it represents a separate unit of accounting. A deliverable constitutes a separate unit of accounting when it has stand-alone value to our customers. Our products and services continue to qualify as separate units of accounting under ASU 2009-13.

There are two major elements in our multiple element arrangements for the delivery of our UltiPro offering, which are recurring revenues (i.e., cloud subscription revenues) and services revenues (mostly implementation consulting services).

For multiple element arrangements, the consideration allocated to cloud subscription revenues is recognized as recurring revenues over the initial contract period, as those subscription-based services are delivered, typically commencing

with the Live date of the related product. The consideration allocated to fixed fee implementation consulting services in multiple element arrangements is recognized as services revenues on a percentage of completion basis, using reasonably dependable estimates with respect to milestones achieved (in relation to progression through implementation phases), by product.

Single element arrangements typically consist of renewals for cloud subscriptions and implementation consulting services sold on a time and materials basis. Under these single element arrangements, cloud subscription revenues are recognized over the related renewal period, as the services are delivered, and implementation consulting services are recognized as the related time and materials services are performed.

We recognize revenues when all of the following criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the fees are fixed and determinable; and
- collection is considered probable.

If collection is not considered probable, we recognize revenues when the fees are collected. If the fees are not fixed and determinable, we recognize revenues when the fees become due from the customer. If non-standard acceptance periods or non-standard performance criteria are required, we recognize revenue when the acceptance period expires or upon the satisfaction of the acceptance/performance criteria, as applicable.

The majority of services revenues are recognized over the implementation period, which is from the contract execution date until the Live date. Cloud revenues are recognized over the initial contract term, typically beginning in the month the customer goes Live.

### **Recurring Revenues**

Recurring revenues primarily consist of subscription revenues recognized from our customers' use of UltiPro after they have gone Live.

i) Cloud subscription revenues are principally derived from PEPM fees earned from UltiPro units that are Live. Ongoing PEPM fees are recognized as subscription revenues as the services are delivered, typically commencing when the customer goes Live.

ii) Effective January 1, 2015, we no longer have maintenance revenues associated with our Legacy customers. Since the time we announced that we would stop supporting our Legacy product in 2012, we successfully converted the majority of our Legacy customers to the cloud. Those customers that did not convert terminated.

With UltiPro, our customers do not have the right to take possession of our software and these arrangements are considered service contracts. The selling price of multiple deliverables in cloud arrangements is derived for each element based on the guidance provided by ASU 2009-13. The multiple elements that typically exist in cloud arrangements include (1) recurring revenues from the combination of hosting services, the right to use UltiPro, and maintenance of UltiPro (i.e., product enhancements, updates and customer support) and (2) professional services (i.e., primarily implementation consulting services).

The pricing for the three elements that pertain to recurring revenues (i.e., hosting services, the right to use UltiPro and maintenance of UltiPro (as described above) is bundled. Since these three bundled elements are components of recurring revenues in the consolidated statements of income, allocation of selling price to each of the three elements is not necessary and they are not reported separately. Selling price, which is established through VSOE, for the bundled elements, as a whole, is determined on the basis of renewal pricing, without taking into consideration potential price increases or potential changes in the number of employees of the customer in the future due to the uncertainties surrounding these potential occurrences. These bundled elements are provided on an ongoing basis, represent undelivered elements and are recognized on a monthly basis as the related services are performed, commencing once the customer goes Live.

### **Services Revenues**

Services revenues primarily include revenues from fees charged for implementation consulting services in connection with the implementation of our product solutions and, to a much lesser extent, fees for other services, including the provision of payroll-related forms, sales of time clocks and the printing of W-2 forms for certain customers, as well as certain client reimbursable out-of-pocket expenses.

Our multiple element contracts contain recurring cloud revenues and implementation consulting services priced on a fixed fee basis. Time and materials implementation consulting services are sold as stand-alone sales not directly related to the

basic implementation of the cloud product. The total arrangement consideration is allocated to services elements in the arrangement based on relative selling prices, using the prices established when the services are sold on a stand-alone basis. Selling price is established through ESP for fixed fee implementation consulting services that are included in our multiple element contracts.

Revenues from implementation consulting services sold on a fixed-fee basis are recognized using the percentage of completion accounting method, which involves the use of estimates. Percentage of completion is measured at each reporting date based on progress made to date, using reasonably dependable estimates with respect to milestones achieved or billable hours, as applicable.

Revenues from implementation consulting services, billed on a time and materials basis (at an hourly rate), are recognized as these services are performed. Other services are recognized as the product is shipped or as the services are rendered, depending on the specific terms of the related arrangement.

### **Goodwill and Intangible Assets**

The purchase price of an acquired company is allocated between intangible assets and the net tangible assets of the acquired business with the residual of the purchase price recorded as goodwill. The determination of the value of the intangible assets acquired involves certain judgments and estimates. These judgments and estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future and the appropriate weighted average cost of capital.

At December 31, 2016, our goodwill totaled \$35.3 million and our identifiable net intangible assets totaled \$23.9 million. We assess the impairment of goodwill of our reporting unit annually, or more often if events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is tested for impairment at the reporting unit level by first performing a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying value. If the reporting unit does not pass the qualitative assessment, then the reporting unit's carrying value is compared to its fair value. We consider both market and discounted cash flow approaches to determine the fair value of the reporting unit. Goodwill is considered impaired if the carrying value of the reporting unit exceeds its fair value. The discounted cash flow approach uses expected future operating results. Failure to achieve these expected results may cause a future impairment of goodwill at the reporting unit. We conducted our annual impairment test of goodwill as of December 31, 2016, and 2015. As a result of this test, we determined that no adjustment to the carrying value of goodwill for our reporting unit was required.

We evaluate our amortizable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on expected undiscounted cash flows attributable to that asset or group of assets. The amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. We also evaluate the estimated remaining useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. Assumptions and estimates about future values and remaining useful lives of our intangible assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends and internal factors such as changes in our business strategy and our internal forecasts.

### **Cost of Revenues**

Cost of revenues primarily consists of the costs of recurring and services revenues. Cost of recurring revenues primarily consists of costs to provide maintenance and technical support to our customers, the cost of providing periodic updates and the cost of recurring subscription revenues, including amortization of capitalized software. Cost of services revenues primarily consists of costs to provide implementation consulting services and, to a lesser degree, training to our customers, costs related to sales of payroll-related forms, time clocks and costs associated with certain client reimbursable out-of-pocket expenses.

### **Stock-Based Compensation**

Our Amended and Restated 2005 Equity and Incentive Plan (the "Plan") authorizes the grant of options to non-employee directors, officers and employees of Ultimate to purchase shares of Ultimate's Common Stock. The Plan also authorizes the grant to such persons of restricted and non-restricted shares of Common Stock, stock appreciation rights, stock units and cash performance awards (collectively, together with stock options, the "Awards"). Prior to the adoption of the Plan, options to purchase shares of Common Stock were issued under our Nonqualified Stock Option Plan (the "Prior Plan"). Beginning in 2009, we began making grants to employees of restricted stock units in lieu of stock options.

As of December 31, 2016, the aggregate number of shares of Common Stock that were available to be issued under all Awards granted under the Plan was 1,162,546 shares.

The Plan provides broad discretion to the Compensation Committee of the Board of Directors to create appropriate equity incentives for directors, officers and employees of Ultimate. The Plan is intended to attract and retain talented employees and align employee and stockholder interests.

For purposes of calculating and accounting for stock-based compensation expense (“SBC”) in accordance with ASC 718, “Compensation – Stock Compensation” (“ASC 718”) for restricted stock awards and restricted stock units, we measure compensation based on the closing market price of our Common Stock at the date of grant and it is recognized on a straight-line basis over the vesting period. We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The weighted-average forfeiture rate is based on historical data.

In accordance with ASC 718, Ultimate capitalizes the portion of SBC expense attributed to personnel whose labor costs are being capitalized pursuant to ASC Topic 350-40, *Intangibles Goodwill and Other-Internal Use Software*, related to software development. The following table summarizes SBC recognized by the Company (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
SBC - Statements of income .....	\$ 113,877	\$ 82,416	\$ 46,185
SBC - Capitalized software .....	3,903	3,013	1,730
SBC - Statements of stockholders' equity .....	<u>\$ 117,780</u>	<u>\$ 85,429</u>	<u>\$ 47,915</u>

#### **Rental Costs Incurred in Relation to a Construction Period**

We have incurred rental costs associated with operating leases during the construction period. Rental costs incurred during a construction period are costs incurred for the right to control the use of a leased asset during and after construction of a leased asset. Since there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period, rental costs associated with ground or building operating leases that are incurred during a construction period are recognized as rental expense on a straight-line basis.

#### **Income Taxes**

We are subject to Federal, foreign and state corporate income taxes. We account for income taxes using an asset and liability approach under which deferred income taxes are provided based upon enacted tax laws and rates applicable to the periods in which the taxes become payable.

We make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes.

We assess the likelihood that Ultimate will be able to recover its deferred tax assets. Management considers all available evidence, both positive and negative, including historical levels of pre-tax book income, expiration of net operating losses, expectations and risks associated with estimates of future taxable income and ongoing prudent and feasible tax planning strategies, as well as current tax laws and interpretation of current tax laws, in assessing the need for a valuation allowance. If recovery is not likely, we record a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. The available positive evidence at December 31, 2016 included, among other factors, three years of cumulative historical pre-tax book income and a projection of future pre-tax book income and taxable income sufficient to realize all of our remaining deferred tax assets. As a result of our analysis of all available evidence, both positive and negative, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize all of the deferred tax assets as of December 31, 2016. See Note 14 for further discussion.

ASC 740, "Income Taxes" ("ASC 740") provides guidance on the related de-recognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. Our accounting policy is to record the tax effects of a change in the opening balance of the unrecognized tax benefits (including unrecognized tax benefits related to prior-period discontinued operations) in current-period income (loss) from continuing operations. We recognize interest and penalties accrued related to unrecognized tax benefits as components of our income tax provision. We did not have any interest and penalties accrued upon the adoption of ASC 740, and, as of December 31, 2016 and 2015, we did not have any interest and penalties accrued related to unrecognized tax benefits.

## Reimbursable Out-Of-Pocket Expenses

Reimbursable out-of-pocket expenses, which are included in services revenues and cost of services revenues in our accompanying consolidated statements of operations, were \$2.4 million, \$1.9 million and \$1.8 million for 2016, 2015 and 2014, respectively.

## Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “*Revenue from Contracts with Customers: (Topic 606)*” and issued subsequent amendments to the initial guidance in August 2015, March 2016, April 2016 and May 2016 within ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12, respectively (ASU 2014-09, ASU 2015-14, ASU 2016-08, ASU 2016-10 and ASU 2016-12 collectively, Topic 606). Topic 606 supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of Topic 606 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. Topic 606 defines a five-step process (ASC 606-10-05-4(a) through 4 (e)) to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation, among others. Topic 606 also provides guidance on the recognition of costs related to obtaining customer contracts.

During 2016 we began discussions that addressed the potential impact Topic 606 would have on the consolidated financial statements and the required resources to implement the new standard. Assessment to the impact on the consolidated financial statements included an evaluation of the five steps outlined in ASC 606-10-05-4 (a) through (e) of 2016 along with enhancement of disclosures that will be required under paragraphs 606-10-50-1 through 50-21. In Ultimate’s evaluation of the standard, it has developed its initial plan for implementing the standard, which includes, but is not limited to, identifying contract populations and “in scope” contracts, identifying performance obligations in the “in scope” customer contracts, and evaluating impacts of variable consideration. It also includes determining the impacts the standard will have on the revenue reporting processes, ensuring the internal controls will operate effectively with the new standard and performing gap analyses on collected data and determining the relative accounting positions where applicable. Included in our assessment of the standard, we will focus on the potential impact on sales commissions and the term over which they will amortize. We have preliminarily determined that the implementation revenues that we recognize represent distinct performance obligations and do not believe the standard will materially alter the way we recognize revenues. We are still evaluating the overall effect the standard will have on the consolidated financial statements and related disclosures.

Topic 606 is effective for Ultimate on January 1, 2018 using either of two methods: (1) retrospective application of Topic 606 to each prior reporting period presented with the option to elect certain practical expedients as defined within Topic 606 or (2) retrospective application of Topic 606 with the cumulative effect of initially applying Topic 606 recognized at the date of initial application and providing certain additional disclosures as defined per Topic 606. Ultimate has not yet selected a transition method.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): “*Balance Sheet Classification of Deferred Taxes*” (“ASU 2015-17”). ASU 2015-17 requires entities to offset all deferred tax assets and liabilities (and valuation allowances) for each tax-paying jurisdiction within each tax-paying component and present the net deferred tax as a single noncurrent amount in a classified balance sheet. The new standard was effective for Ultimate on January 1, 2017. The standard permits the use of either the prospective or retrospective method. We are evaluating the effect that ASU 2015-17 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method.

In February 2016, the FASB issued ASU 2016-02, “*Leases*” (“ASU 2016-02”), to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard is effective for Ultimate on January 1, 2019 and early adoption is permitted. The standard requires lessees and lessors to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. We are evaluating the effect that ASU 2016-02 will have on our consolidated financial statements and related disclosures. We have not yet determined the effect the standard will have on our ongoing financial reporting.

## Recently Adopted Accounting Standards

In March 2016, the FASB issued ASU 2016-09, “*Improvements to Employee Share-Based Payment Accounting*” (“ASU 2016-09”). The standard amends the accounting for certain aspects of share-based payments to employees. The standard requires transition for specific objectives of the standard. Amendments related to the timing of when excess tax

benefits are recognized, minimum statutory withholding requirements, and forfeitures should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement should be applied prospectively. Further, an entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method. The new standard is effective for us beginning January 1, 2017, with early adoption permitted.

We elected to early adopt the new guidance in the third quarter of fiscal year 2016 which requires us to reflect any cumulative-effect and prospective method adjustments as of January 1, 2016, the beginning of the annual period that includes the interim period of adoption. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than additional paid-in capital for all periods in fiscal year 2016. Prior to the adoption of ASU 2016-09, companies could not recognize excess tax benefits (the amount by which the tax deduction exceeds the financial statement expense previously recorded) when a restricted stock unit or restricted stock award vested or an option was exercised if the related tax deduction resulted in an increase to a net operating loss carryforward rather than a reduction in income taxes payable. Consequently, the excess tax benefits were credited to additional paid-in-capital and a deferred tax asset was established, only to the extent realized through a reduction in income taxes payable, which resulted in the excess tax benefits being included in Ultimate's net operating loss carryforwards, while being excluded from deferred tax assets on the balance sheet. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. Adoption of the new standard resulted in a \$39.7 million cumulative-effect adjustment as of January 1, 2016 to record a deferred tax asset with the offset to retained earnings in the balance sheet, representing the amount of our net operating loss carryforwards attributable to excess tax benefits. Additional amendments to the accounting for minimum statutory withholding tax requirements had no impact to retained earnings as of January 1, 2016, where the cumulative effect of these changes is required to be recorded. We have elected to continue to estimate forfeitures expected to occur to determine the amount of non-cash stock-based compensation costs to be recognized in each period.

We elected to apply the presentation requirements for cash flows related to excess tax benefits retrospectively to all periods presented which resulted in a reclassification of previously reported amounts to increase both net cash from operations and net cash used in financing of \$31.9 million and \$27.5 million for the years ended December 31, 2015 and 2014, respectively. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to any of the periods presented in our consolidated cash flows statements since such cash flows have historically been presented as a financing activity.

Adoption of the new standard resulted in the recognition of excess tax benefits in our provision for income taxes rather than additional paid-in capital of \$23.7 million for the year ended December 31, 2016.

In April 2015, the FASB issued ASU 2015-05, "*Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*" ("ASU 2015-05"), which requires that if a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. Further, it requires that if a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 will not change GAAP for a customer's accounting for service contracts. The new standard became effective for Ultimate on January 1, 2016. The effect of the adoption of ASU 2015-05 has had no material impact on our consolidated financial statements and related disclosures.

#### **4. Business Combinations**

##### **2016 Business Combinations**

During the third quarter of 2016, we completed the acquisition of Kanjoya, Inc. ("Kanjoya"), a California corporation (the "Kanjoya Acquisition"), located in San Francisco, California. During the second quarter of 2016, we completed the acquisition of substantially all of the assets of Capital Analytics, Inc. (d/b/a Vestrics) (hereinafter referred to as "Vestrics") (the "Vestrics Acquisition"), a Delaware limited liability company located in North Carolina. The Kanjoya Acquisition and the Vestrics Acquisition (the "2016 Acquisitions") were deemed insignificant to the audited condensed consolidated financial statements on an individual basis and in the aggregate.

##### ***Acquisition of Kanjoya, Inc.***

On September 29, 2016, pursuant to a merger agreement with Kanjoya, we acquired Kanjoya in exchange for \$19.6 million, of which \$16.9 million was paid in cash during the twelve months ended December 31, 2016 while the remaining \$2.6 million is being held in escrow, and is included in accrued liabilities on our consolidated balance sheet. We recorded the



Kanjoya Acquisition using the acquisition method of accounting and recognized assets and liabilities assumed at their fair value as of the date of acquisition. Based on the valuation, the significant classes of assets and liabilities to which we allocated the purchase price of Kanjoya were acquired intangibles for a total of \$13.6 million, consisting of \$12.1 million for developed technology, \$1.5 million for customer relationships, and goodwill for the balance of \$6.4 million. Pursuant to the Kanjoya Acquisition we assumed working capital, net, totaling \$0.4 million. The fair value of the acquired developed technology was estimated using the cost approach. In accordance with GAAP, direct costs related to the acquisition were expensed as incurred. Kanjoya is a leading cloud workforce intelligence provider for enterprises. Based upon the technology acquired, we launched UltiPro Perception, a feature-set that enables businesses to identify and analyze attitudes and performance traits of their employees, managers, and teams from surveys and other sources of employee feedback. Kanjoya's workforce has joined Ultimate and will serve to establish an additional research and development hub for us in San Francisco.

The results of operations from this acquisition have been included in our consolidated financial statements since the closing of the Kanjoya Acquisition. Pro forma results of operations have not been presented because the effects of this business combination were not deemed significant to our audited condensed consolidated results of operations.

#### ***Acquisition of Capital Analytics, Inc., d/b/a Vestrics***

On May 11, 2016 (the "Vestrics Closing Date"), pursuant to an asset purchase agreement with Vestrics, we acquired certain assets and liabilities in exchange for \$10.1 million, of which \$9.1 million was paid in cash during the twelve months ended December 31, 2016 while the remaining \$1.0 million is being held in escrow and is included in accrued liabilities on our unaudited condensed consolidated balance sheet. We recorded the Vestrics Acquisition using the acquisition method of accounting and recognized assets and liabilities assumed at their fair value as of the date of acquisition. The valuation of Vestrics has been completed and the significant classes of assets and liabilities to which we allocated the purchase price were goodwill of \$4.3 million (which includes working capital, net, totaling \$0.2 million, which was assumed pursuant to the Vestrics Acquisition) and identifiable intangible assets of \$6.0 million related to developed technology. In accordance with GAAP, direct costs related to the acquisition were expensed as incurred. Vestrics' predictive technology enables a company to identify and analyze the connections between its investments in human capital and the performance-related business results of those investments. We will leverage Vestrics' technology as we continue to expand our analytics capabilities across UltiPro. The fair value of the acquired developed technology was estimated using the cost approach. Identifiable intangible assets were assigned a total weighted-average amortization period of 7.0 years. Since the developed predictive technology acquired pursuant to the Vestrics Acquisition will be included in the development project currently being capitalized as internal-use software to be offered as a cloud product in the future, amortization of the Vestrics developed technology will begin when it is ready for its intended use.

The results of operations from this acquisition have been included in our audited condensed consolidated financial statements since the Vestrics Closing Date. Pro forma results of operations have not been presented because the effects of this business combination were not deemed significant to our audited condensed consolidated results of operations.

#### **5. Funds Held for Customers, Corporate Investments in Marketable Securities and Fair Value of Financial Instruments**

We classify our investments in marketable securities with readily determinable fair values as available-for-sale. Available-for-sale securities consist of debt and equity securities not classified as trading securities or as securities to be held to maturity. Unrealized gains and losses, net of tax, on available-for-sale securities are reported as a net amount in accumulated other comprehensive loss in stockholders' equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. Included in accumulated other comprehensive loss was a \$145 thousand net unrealized loss and \$84 thousand net unrealized loss on available-for-sale securities at December 31, 2016 and December 31, 2015, respectively. Realized gains and losses resulting on available-for-sale securities are included in other (expense) income, net, in the consolidated statements of income. There were no significant reclassifications of realized gains and losses on available-for-sale securities to the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014.

The amortized cost, net unrealized (loss) gain and fair value of our investments in marketable available-for-sale securities as of December 31, 2016 and December 31, 2015 are shown below (in thousands):

Funds held for customers and corporate investments as of December 31, 2016 and December 31, 2015 are shown below (in thousands):

Type of issue:	As of December 31, 2016			As of December 31, 2015		
	Amortized Cost	Net Unrealized (Loss) Gain	Fair Value (1)	Amortized Cost	Net Unrealized (Loss)	Fair Value (1)
Funds held for customers – money market securities and other cash equivalents.....	\$ 316,353	\$ —	\$ 316,353	\$ 853,392	\$ —	\$ 853,392
Available-for-sale securities:						
Corporate debentures – bonds .....	10,175	(3)	10,172	13,232	(31)	13,201
Commercial paper.....	1,446	—	1,446	2,097	—	2,097
U.S. Agency bonds .....	148,939	(125)	148,814	70,208	(44)	70,164
U.S. Treasury bills .....	9,586	(18)	9,568	703	(3)	700
Asset-Backed Securities .....	2,901	1	2,902	3,818	(6)	3,812
Total corporate investments and funds held for customers .....	<u>\$ 489,400</u>	<u>\$ (145)</u>	<u>\$ 489,255</u>	<u>\$ 943,450</u>	<u>\$ (84)</u>	<u>\$ 943,366</u>

(1) Included within available-for-sale securities as of December 31, 2016 and 2015 are corporate investments with fair values of \$24.1 million and \$20.1 million, respectively. Included within available-for-sale securities as of December 31, 2016 and 2015 are funds held for customers with fair values of \$148.8 million and \$69.9 million, respectively. All available-for-sale securities were included in Level 2 of the fair value hierarchy.

The unrealized losses and fair values of available-for-sale securities that have been in an unrealized loss position for a period of less than and greater than 12 months as of December 31, 2016 are as follows (in thousands):

	Securities in unrealized loss position less than 12 months		Securities in unrealized loss position greater than 12 months		Total	
	Unrealized losses	Fair market value	Unrealized losses	Fair market value	Gross unrealized losses	Fair market value
Corporate debentures – bonds...	\$ (4)	\$ 6,125	\$ —	\$ —	\$ (4)	\$ 6,125
Commercial paper .....	—	—	—	—	—	—
U.S. Agency bonds.....	(131)	118,810	—	—	(131)	118,810
U.S. Treasury bills.....	(18)	9,568	—	—	(18)	9,568
Asset-Backed Securities.....	(1)	751	—	—	(1)	751
Total.....	<u>\$ (154)</u>	<u>\$ 135,254</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (154)</u>	<u>\$ 135,254</u>

The unrealized losses and fair values of available-for-sale securities that have been in an unrealized loss position for a period of less than and greater than 12 months as of December 31, 2015 are as follows (in thousands):

	Securities in unrealized loss position less than 12 months		Securities in unrealized loss position greater than 12 months		Total	
	Unrealized losses	Fair market value	Unrealized losses	Fair market value	Gross unrealized losses	Fair market value
Corporate debentures – bonds...	\$ (31)	\$ 12,451	\$ (1)	\$ 300	\$ (32)	\$ 12,751
Commercial paper .....	—	—	—	—	—	—
U.S. Agency bonds.....	(51)	70,004	—	—	(51)	70,004
U.S. Treasury bills.....	(3)	700	—	—	(3)	700
Asset-Backed Securities.....	(6)	3,813	—	—	(6)	3,813
Total.....	<u>\$ (91)</u>	<u>\$ 86,968</u>	<u>\$ (1)</u>	<u>\$ 300</u>	<u>\$ (92)</u>	<u>\$ 87,268</u>

The amortized cost and fair value of the marketable available-for-sale securities by contractual maturity at December 31, 2016 are shown below (in thousands):

	As of December 31, 2016	
	Amortized Cost	Fair Value
Due in one year or less .....	\$ 120,234	\$ 120,190
Due after one year .....	52,813	52,712
Total.....	<u>\$ 173,047</u>	<u>\$ 172,902</u>

We classify and disclose fair value measurements in one of the following three categories of fair value hierarchy:

- Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities.
- Level 2: Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly.
- Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Our assets that are measured by management at fair value on a recurring basis are generally classified within Level 1 or Level 2 of the fair value hierarchy. The types of instruments valued based on quoted market prices in active markets include most money market securities. Such instruments are generally classified within Level 1 of the fair value hierarchy. We did not have any transfers into and out of Level 1 and Level 2 during the years ended December 31, 2016, 2015 and 2014.

The types of instruments valued by management, based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency, include corporate debentures and bonds, commercial paper, U.S. agency bonds, and U.S. Treasury bills. Such instruments are generally classified within Level 2 of the fair value hierarchy. We use consensus pricing, which is based on multiple pricing sources, to value our fixed income investments.

The following table sets forth, by level within the fair value hierarchy, financial assets accounted for at fair value as of December 31, 2016 and December 31, 2015 (in thousands):

	As of December 31, 2016				As of December 31, 2015			
	Total	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Un-Observable Inputs (Level 3)	Total	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Un-Observable Inputs (Level 3)
Corporate debentures and bonds .....	\$ 10,172	\$ —	\$ 10,172	\$ —	\$ 13,201	\$ —	\$ 13,201	\$ —
Commercial paper.....	1,446	—	1,446	—	2,097	—	2,097	—
U.S. Agency bonds .....	148,814	—	148,814	—	70,164	—	70,164	—
U.S. Treasury bills .....	9,568	—	9,568	—	700	—	700	—
Asset-Backed Securities .	2,902	—	2,902	—	3,812	—	3,812	—
Total.....	<u>\$ 172,902</u>	<u>\$ —</u>	<u>\$ 172,902</u>	<u>\$ —</u>	<u>\$ 89,974</u>	<u>\$ —</u>	<u>\$ 89,974</u>	<u>\$ —</u>

Assets and liabilities measured at fair value on a recurring basis were presented in the consolidated balance sheets as of December 31, 2016 and as of December 31, 2015 as short-term and long-term investments in marketable securities. There were no financial liabilities accounted for at fair value as of December 31, 2016 and December 31, 2015.

## 6. Allowance for Doubtful Accounts

We have established an allowance for doubtful accounts based on a review of the current status of existing accounts receivable by customer and historical experience.

The activity within the allowance for doubtful accounts was as follows (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Balance at beginning of year.....	\$ 900	\$ 675	\$ 675
Charged to expense .....	3,213	4,687	2,264
Write-offs .....	(3,213)	(4,462)	(2,264)
Balance at end of year .....	<u>\$ 900</u>	<u>\$ 900</u>	<u>\$ 675</u>

#### 7. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following (in thousands):

	<b>As of December 31,</b>	
	<b>2016</b>	<b>2015</b>
Prepaid commissions on cloud sales.....	\$ 29,842	\$ 22,119
Other prepaid expenses.....	16,753	11,978
Other current assets.....	15,306	12,707
Total prepaid expenses and other current assets.....	<u>\$ 61,901</u>	<u>\$ 46,804</u>

#### 8. Property and Equipment, net

Property and equipment, net consists of the following (in thousands):

	<b>As of December 31,</b>	
	<b>2016</b>	<b>2015</b>
Computer equipment .....	\$ 166,420	\$ 140,297
Internal-use software .....	113,407	75,529
Leasehold improvements .....	36,095	25,246
Furniture and fixtures .....	16,932	12,316
Building .....	1,074	1,005
Land .....	655	655
Property and equipment.....	<u>334,583</u>	<u>255,048</u>
Less: accumulated depreciation and amortization.....	155,025	129,556
Property and equipment, net.....	<u>\$ 179,558</u>	<u>\$ 125,492</u>

Depreciation and amortization expense on property and equipment, including depreciation and amortization expense on property and equipment under capital leases, totaled \$25.5 million, \$20.7 million and \$18.1 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Included in property and equipment, net, is computer equipment acquired under capital leases as follows (in thousands):

	<b>As of December 31,</b>	
	<b>2016</b>	<b>2015</b>
Computer equipment .....	\$ 51,581	\$ 44,862
Less: accumulated amortization .....	43,732	38,389
Computer equipment, net.....	<u>\$ 7,849</u>	<u>\$ 6,473</u>

Capital leases entered into and included in property and equipment totaled \$6.7 million, \$5.9 million and \$5.9 million for the years ended December 31, 2016, 2015 and 2014, respectively.

See Note 10 in the Notes to Consolidated Financial Statements for further discussion of computer software development costs related to internal-use software which is included in property and equipment, net.

## 9. Foreign Currency

The financial statements of Ultimate's foreign subsidiaries have been translated into U.S. dollars. The functional currency of our wholly-owned subsidiary, The Ultimate Software Group of Canada, Inc., is the Canadian dollar. Assets and liabilities are translated into U.S. dollars at period-end exchange rates. Income and expenses are translated at the average exchange rate for the reporting period. The resulting non-cash foreign currency translation adjustments, representing unrealized gains or losses, are included in consolidated stockholders' equity as a component of accumulated other comprehensive income (loss). Realized gains and losses resulting from foreign exchange transactions are included in total operating expenses in the consolidated statements of operations. Included in accumulated other comprehensive income (loss), as presented in the accompanying consolidated balance sheets, are \$6.9 million of unrealized translation losses at December 31, 2016 and \$7.8 million of unrealized translation losses at December 31, 2015. There were no significant reclassifications of realized gains and losses resulting from foreign exchange transactions to the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014.

Included in comprehensive income (loss) for the years ended December 31, 2016, 2015 and 2014 were realized foreign currency translation losses and unrealized foreign currency translation gains (losses), as follows (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Realized foreign currency translation (loss) gains .....	\$ —	\$ —	\$ —
Unrealized foreign currency translation gains (losses) .....	\$ 843	\$ (4,195)	\$ (2,143)

## 10. Computer Software Development Costs

We previously capitalized software costs in accordance with Accounting Standards Codification ("ASC") Topic 985-20, *Costs of Software to Be Sold, Leased, or Marketed*. Those capitalized software costs were fully amortized as of December 31, 2013.

Computer software development costs related to software developed for internal use falls under the accounting guidance of ASC Topic 350-40, *Intangibles Goodwill and Other-Internal Use Software*. These capitalized costs are included with property and equipment in the consolidated balance sheets and purchases of property and equipment in the statements of cash flows. Internal-use software is amortized on a straight-line basis over its estimated useful life, generally three to seven years, commencing after the software development is substantially complete and the software is ready for its intended use.

For the years ended December 31, 2016 and 2015, we capitalized \$37.9 million (including \$3.9 million in non-cash stock-based compensation) and \$26.3 million (including \$3.0 million in non-cash stock-based compensation), respectively, of computer software development costs related to an internal-use development project for our UltiPro product offering (the "Development Project"). The capitalized costs for the Development Project were primarily from direct labor costs. For 2016, 2015 and 2014, we recognized \$1.2 million, \$1.1 million and \$0.7 million, respectively, of amortization costs which were associated with certain product modules, of the Development Project which were ready for their intended use. The amortization of capitalized software is included in cost of recurring revenues. At each balance sheet date, we evaluate the useful lives of these assets and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

Capitalized computer software development costs and accumulated amortization of capitalized software, developed for internal use, were as follows (in thousands):

	<b>As of December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Computer software development costs .....	\$ 113,407	75,529	49,464
Less: accumulated amortization .....	(2,925)	(1,742)	(670)
Computer software development costs, net .....	<u>110,482</u>	<u>73,787</u>	<u>48,794</u>

## 11. Earnings Per Share

Earnings per share calculations require a dual presentation — “basic” and “diluted.” Basic earnings per share is computed by dividing income available to common stockholders (the numerator) by the weighted average number of common shares (the denominator) for the period. The computation of diluted earnings per share is similar to basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

The following is a reconciliation of the shares used in the computation of basic and diluted net income per share (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Basic weighted average shares outstanding .....	28,976	28,634	28,293
Effect of dilutive equity instruments (1) .....	1,438	1,087	1,050
Dilutive shares outstanding .....	<u>30,414</u>	<u>29,721</u>	<u>29,343</u>
Anti-dilutive equity instruments (1) .....	<u>24</u>	<u>19</u>	<u>40</u>

(1) Includes options to purchase shares of Common Stock and other stock-based awards outstanding.

## 12. Goodwill and Intangible Assets

Goodwill represents the excess of cost over the net tangible and identifiable intangible assets of acquired businesses. Goodwill amounts are not amortized, but rather tested for impairment at least annually. Identifiable intangible assets acquired in business combinations are recorded based upon fair value at the date of acquisition and amortized over their estimated useful lives.

The changes in the carrying value of goodwill were as follows (in thousands):

	<b>As of December 31,</b>	
	<b>2016</b>	<b>2015</b>
Goodwill, December 31, 2015 .....	\$ 24,410	\$ 25,696
Goodwill from Vestrics Acquisition (1) .....	4,305	—
Goodwill from Kanjoya Acquisition (2) .....	6,394	—
Translation adjustment (3) .....	213	(1,286)
Goodwill, December 31, 2016 .....	<u>\$ 35,322</u>	<u>\$ 24,410</u>

(1) Represents the goodwill recognized for the Vestrics Acquisition on May 11, 2016. See Note 4 of the Notes to Consolidated Financial Statements.

(2) Represents the estimated goodwill recognized for the Kanjoya Acquisition on September 29, 2016. See Note 4 of the Notes to Consolidated Financial Statements.

(3) Represents the impact of the foreign currency translation of the portion of goodwill that is recorded by our Canadian subsidiary whose functional currency is also its local currency. Such goodwill is translated into U.S. dollars using exchange rates in effect at period end. Adjustments related to foreign currency translation are included in other comprehensive income (loss).

The Company's amortizable intangible assets have estimated useful lives as follows (in thousands):

<b>As of December 31, 2016</b>					
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Cumulative Translation Adjustment (1)</b>	<b>Net Carrying Amount</b>	<b>Weighted Average Remaining Useful Life</b>
Developed technology .....	\$ 23,300	\$ (2,036)	\$ (1,026)	\$ 20,238	6.7
Customer relationships .....	4,700	(1,194)	—	3,506	5.3
Non-compete agreements .....	300	(300)	—	—	0.0
	<u>\$ 28,300</u>	<u>\$ (3,530)</u>	<u>\$ (1,026)</u>	<u>\$ 23,744</u>	<u>6.5</u>

<b>As of December 31, 2015</b>					
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Cumulative Translation Adjustment (1)</b>	<b>Net Carrying Amount</b>	<b>Weighted Average Remaining Useful Life</b>
Developed technology .....	\$ 5,200	\$ (1,463)	\$ (1,112)	\$ 2,625	4.8
Customer relationships .....	3,200	(736)	(4)	2,460	7.8
Non-compete agreements .....	300	(216)	(2)	82	0.9
	<u>\$ 8,700</u>	<u>\$ (2,415)</u>	<u>\$ (1,118)</u>	<u>\$ 5,167</u>	<u>6.2</u>

(1) Represents the impact of the foreign currency translation of the portion of acquired intangible assets that is recorded by our Canadian subsidiary whose functional currency is also its local currency. Such intangible assets are translated into U.S. dollars using exchange rates in effect at period end. Adjustments related to foreign currency translation are included in other comprehensive income (loss).

Acquired intangible assets are amortized over their estimated useful life, generally three to ten years, in a manner that reflects the pattern in which the economic benefits are consumed. Included in acquired intangible assets as of December 31, 2016, were \$0.1 million of assets with indefinite lives. There were no assets, with indefinite lives, as of December 31, 2015. Amortization expense for acquired intangible assets was \$1.1 million, \$1.0 million and \$1.1 million for the years ended December 31, 2016, 2015 and 2014. Future amortization expense for acquired intangible assets is as follows, as of December 31, 2016 (in thousands):

<b>Year</b>	<b>Amount</b>
2017 .....	\$ 1,812
2018 .....	3,109
2019 .....	3,412
2020 .....	3,323
2021 .....	2,896
Thereafter .....	9,192
Total .....	<u>\$ 23,744</u>

### 13. Capital Lease Obligations

We lease certain equipment under non-cancelable agreements, which are accounted for as capital leases and expire at various dates through 2019. Interest rates on these leases are 4.25% to 4.50%. The scheduled lease payments of the capital lease obligations are as follows as of December 31, 2016 (in thousands):

Year	Amount
2017 .....	\$ 5,346
2018 .....	3,223
2019 .....	883
	<u>9,452</u>
Less amount representing interest .....	(411)
Lease obligations reflected as current (\$5,056) and non-current (\$3,985).	<u>\$ 9,041</u>

### 14. Income Taxes

For the year ended December 31, 2016, the income tax provision of \$11.2 million was based on book income from operations before income taxes of \$41.4 million. For the year ended December 31, 2015, the income tax provision of \$20.4 million was based on book income from operations before income taxes of \$43.1 million. For the year ended December 31, 2014, the income tax provision of \$9.6 million was based on a book loss from operations before income taxes of \$54.3 million. Deferred tax assets and liabilities are determined based on the difference between financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

The income tax provision consists of the following (in thousands):

	For the Year Ended December 31,		
	2016	2015	2014
Current taxes:			
Federal .....	\$ 34	\$ (26,111)	\$ (22,406)
State and local .....	(170)	(6,021)	(5,078)
Foreign .....	(856)	(200)	(567)
Deferred taxes, net .....			
Federal .....	(8,034)	9,548	16,607
State and local .....	(2,289)	2,193	1,535
Foreign .....	150	207	317
Income tax provision.....	<u>\$ (11,165)</u>	<u>\$ (20,384)</u>	<u>\$ (9,592)</u>

The income tax provision is different from that which would be obtained by applying the statutory federal income tax rate of 35% to income from continuing operations before income taxes as a result of the following (in thousands):

	For the Year Ended December 31,		
	2016	2015	2014
Income tax provision at statutory federal tax rate .....	\$ (14,490)	\$ (15,079)	\$ (19,015)
State and local income taxes, net of the federal benefit .....	(1,598)	(2,488)	(2,303)
Non-deductible expenses .....	(19,824)	(6,250)	(2,068)
Change in tax rates .....	216	117	80
Recognition of ASU 2016-09 excess tax benefits, federal benefit.....	20,966	—	—
Research credit, federal benefit.....	3,727	3,239	13,873
Other, net.....	(162)	77	(159)
Income tax provision.....	<u>\$ (11,165)</u>	<u>\$ (20,384)</u>	<u>\$ (9,592)</u>



Deferred tax assets and liabilities reflect the net effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets and liabilities at December 31, 2016 and 2015 were as follows (in thousands):

	<b>As of December 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Deferred tax assets:</b>		
Net operating losses .....	\$ 60,026	\$ 402
Tax credit carryforwards .....	911	817
Research credit .....	22,768	18,758
Deferred revenue .....	918	16
Accruals not currently deductible .....	1,012	790
Allowance for doubtful accounts .....	338	338
Charitable contributions .....	1,777	1,275
Stock-based compensation .....	38,154	58,323
Deferred rent adjustment .....	3,081	1,891
Gross deferred tax assets .....	128,985	82,610
Less valuation allowance .....	—	—
<b>Deferred tax assets</b> .....	<b>\$ 128,985</b>	<b>\$ 82,610</b>
<b>Deferred tax liabilities:</b>		
Property and equipment .....	\$ (49,745)	\$ (32,818)
Foreign, primarily acquired intangible assets .....	(519)	(646)
<b>Gross deferred tax liabilities</b> .....	<b>(50,264)</b>	<b>(33,464)</b>
<b>Net deferred tax assets</b> .....	<b>\$ 78,721</b>	<b>\$ 49,146</b>

Ultimate considers all available evidence, both positive and negative, including historical levels of pre-tax book income, expiration of net operating loss carryforwards, expectations and risks associated with estimates of future taxable income, ongoing prudent and feasible tax planning strategies and reversal of deferred tax liabilities in assessing the need for the valuation allowance. If it is not more likely than not that we will recover our deferred tax assets, we will increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable.

The available positive evidence at December 31, 2016 included, among other factors, three years of cumulative historical pre-tax book income and a projection of future pre-tax book income and taxable income. As a result of our analysis of all available evidence, both positive and negative, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize all of the deferred tax assets as of December 31, 2016. As such, there was no valuation allowance for the years ended December 31, 2016, 2015 and 2014.

Management continues to apply the exception to the comprehensive recognition of deferred income taxes to the undistributed earnings of our foreign subsidiary, Ultimate Canada. The comprehensive recognition of deferred income taxes presumes that all undistributed earnings will be transferred to the parent entity. This presumption may be overcome by the parent entity, and no income taxes would be accrued, if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrates that remittance of the earnings will be postponed indefinitely. These criteria required to overcome the presumption are sometimes referred to as the indefinite reversal criteria. Accordingly, deferred income taxes of \$0.3 million were not recognized on the undistributed earnings of Ultimate Canada. The deferred tax liability, net of available foreign tax credits, resulting from the cumulative undistributed earnings are not deemed material.

We recorded a deferred tax asset, of \$13.2 million and \$2.3 million during 2014, for the years 1998 through 2013, and 2014, respectively, as a result of a research and development credit study. We recorded a deferred tax asset for research and development credits of \$3.2 million and \$4.0 million during the years 2015 and 2016, respectively.

At December 31, 2016, we had approximately \$148.5 million of net operating loss carryforwards for Federal income tax reporting purposes available to offset future taxable income. Prior to January 1, 2016, the tax benefit of net operating loss carryforwards attributable to deductions from the exercise of non-qualified employee, and non-employee director, stock options and the vesting of restricted stock units and restricted stock awards, were credited to paid-in-capital and deferred tax asset only

to the extent realized through a reduction of income taxes payable. As a result, prior to January 1, 2016, the excess tax benefits associated with stock-based compensation were included in net operating loss carryforwards but not reflected in deferred tax assets. Upon adoption of ASU 2016-09, the excess tax benefits associated with stock based compensation were reflected in deferred tax assets. These excess tax benefits combined with the associated financial statement expense (previously included in the stock-based compensation line of this footnote), are currently reflected in the Net operating loss line. During 2015, we realized a tax benefit of \$42.0 million comprised of a \$31.9 million and a \$10.1 million credit to paid-in-capital and deferred tax asset, respectively. During 2014, we realized a tax benefit of \$33.5 million comprised of a \$27.5 million and a \$6.0 million credit to paid-in capital and deferred tax asset, respectively. The carryforwards expire from 2018 through 2034 and from 2016 through 2034, for Federal and state income tax reporting purposes, respectively.

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). The standard amends the accounting for share-based payments to employees effective for annual periods beginning after December 15, 2016, with early adoption permitted. The standard requires transition for specific objectives of the standard. Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. We elected to early adopt ASU 2016-09 in the third quarter of fiscal year 2016 which requires us to reflect any adjustments as of January 1, 2016. The primary impact of adoption was the recognition of excess tax benefits in our provision for income taxes rather than paid-in capital for all periods in fiscal year 2016. ASU 2016-09 requires entities to recognize all income tax effects of stock-based compensation in the income statement when the restricted stock units and awards vest and when the stock options are exercised. Prior to the adoption of ASU 2016-09, companies could not recognize excess tax benefits (the amount by which the tax deduction exceeds the financial statement expense previously recorded) when a restricted stock unit or award vested or an option was exercised if the related tax deduction increased a net operating loss carryforward rather than a reduction in income taxes payable. Consequently, the excess tax benefits were credited to paid-in-capital and a deferred tax asset only to the extent realized through a reduction of income taxes payable when realized, which resulted in the excess tax benefits being included in Ultimate's net operating loss carryforwards, while being excluded from deferred tax assets on the balance sheet. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. Adoption of the new standard resulted in a \$39.7 million cumulative-effect adjustment as of January 1, 2016 to record a deferred tax asset with the offset to retained earnings in the balance sheet representing the amount of our net operating loss carryforward attributable to excess tax benefits. We recognized \$23.7 million of excess tax benefits in our provision for income taxes for the twelve months ended December 31, 2016.

Utilization of such net operating loss carryforwards, as well as tax credit carryforwards, may be limited as a result of cumulative ownership changes in Ultimate's equity instruments due to ownership change provisions of Internal Revenue Code Section 382 and similar state provisions. The Internal Revenue Service examination of our U.S. Federal income tax return for the year ended December 31, 2010 was completed in 2013 with no change to the taxable income or income tax liability as reported.

ASC 740, "Income Taxes," ("ASC 740") requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. During 2013, the Internal Revenue Service completed their examination of our U.S. Federal income tax return for the year ended December 31, 2010, which resulted in the recognition of previously unrecognized tax benefits of approximately \$1.9 million, which decreased our provision for income taxes and our effective tax rate. As of December 31, 2016, we had \$5.0 million of gross unrecognized tax benefits resulting from a research and development credit attributable to the 1998-2014 years as a result of the completion of the research and development activities study that if recognized would affect the annual effective tax rate. During 2015 we increased the unrecognized tax benefits by \$0.1 million related to the completion of the research credit study for 2014 and increased the unrecognized tax benefits by \$0.9 million related to the research credit study estimate for 2015, totaling \$6.0 million at December 31, 2015. During 2016, we increased the unrecognized tax benefits by \$0.2 million related to the completion of the research credit study for 2015 and increased the unrecognized tax benefits by \$1.1 million related to the research credit study estimate for 2016, totaling \$7.2 million at December 31, 2016. While it is often difficult to predict the final outcome of any particular uncertain tax position, management does not believe that it is reasonably possible that the estimates of unrecognized tax benefits will change significantly in the next twelve months.

Tax years 1998 to 2016 remain subject to future examination by the tax jurisdictions in which we are subject to tax.

We recognize interest and penalties accrued related to unrecognized tax benefits as components of our income tax provision. Due to our net operating loss carryover position, we did not have any interest and penalties accrued upon the

adoption of ASC 740, and, as of December 31, 2016 and 2015, we did not have any interest and penalties accrued related to unrecognized tax benefits.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for the years ended December 31, 2016, 2015 and 2014 is as follows (in thousands):

	As of December 31,		
	2016	2015	2014
Balance at January 1, .....	\$ 5,957	\$ 4,950	\$ —
Tax positions taken in prior period.....			
Gross increases .....	205	133	—
Gross decreases.....	—	—	—
Tax positions taken in current period.....			
Gross increases .....	1,079	874	4,950
Settlements .....	—	—	—
Statute expiration .....	—	—	—
Balance at December 31, .....	<u>\$ 7,241</u>	<u>\$ 5,957</u>	<u>\$ 4,950</u>

## 15. Stock-Based Compensation and Equity

### Summary of Plans

Our Amended and Restated 2005 Equity and Incentive Plan (the “Plan”) authorizes the grant of options (“Options”) to non-employee directors, officers and employees of Ultimate to purchase shares of Ultimate's Common Stock (“Common Stock”). The Plan also authorizes the grant to such persons of restricted and non-restricted shares of Common Stock, stock appreciation rights, stock units and cash performance awards (collectively, together with the Options, the “Awards”).

As of December 31, 2016, the aggregate number of shares of Common Stock that were available to be issued under all Awards granted under the Plan was 1,162,546 shares.

### Stock-Based Compensation

The following table sets forth the non-cash stock-based compensation expense resulting from stock-based arrangements that is recorded in our consolidated statements of income for the periods indicated (in thousands):

	For the Years Ended December 31,		
	2016	2015	2014
Cost of recurring revenues .....	\$ 8,613	\$ 6,303	\$ 5,495
Cost of services revenues.....	6,198	5,017	4,446
Sales and marketing .....	59,187	41,059	20,767
Research and development.....	8,238	6,180	4,788
General and administrative .....	31,641	23,857	10,689
Total stock-based compensation expense .....	<u>\$ 113,877</u>	<u>\$ 82,416</u>	<u>\$ 46,185</u>

Stock-based compensation for the twelve months ended December 31, 2016 was \$113.9 million, as compared with stock-based compensation of \$82.4 million and \$46.2 million for the twelve months ended December 31, 2015 and 2014, respectively. The increases of \$31.5 million and \$67.7 million in stock-based compensation over 2015 and 2014, respectively, included increases of \$19.7 million and \$42.8 million, respectively, associated with modifications made to the Company’s CIC Plans in March 2015 and February 2016 which significantly reduced the potential payments that could be made under such plans. As previously disclosed, these changes were made to better align management's incentives with long-term value creation for our shareholders. As part of the modifications in connection with unwinding the change in control plans, time-based restricted stock awards (vesting over three years) were granted to certain senior officers in March 2015 and February 2016.

The following table sets forth the stock-based compensation expense associated with modifications made to the Company's change in control plans as discussed above (in thousands):

	<b>For the Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Stock-based compensation expense:</b>			
Stock-based compensation expense .....	\$ 71,119	\$ 59,390	\$ 46,185
Stock-based compensation expense related to CIC modifications .....	42,758	23,026	—
Total non-cash stock-based compensation expense.....	<u>\$ 113,877</u>	<u>\$ 82,416</u>	<u>\$ 46,185</u>

Included in computer equipment in property and equipment, net in our consolidated balance sheet and excluded from purchases of property and equipment in the statements of cash flow at December 31, 2016, 2015 and 2014 was \$3.9 million, \$3.0 million and \$1.7 million, respectively, in non-cash stock-based compensation expense related to capitalized software which was developed for internal use during the fiscal years then ended. These amounts would have otherwise been charged to research and development expense for the years ended December 31, 2016, 2015 and 2014.

Net cash proceeds from the exercise of Options were \$4.7 million, \$4.7 million and \$6.2 million for the years ended December 31, 2016, 2015 and 2014, respectively.

### **Fair Value**

The fair value of restricted stock awards and restricted stock units is equal to the closing price of our Common Stock on NASDAQ on the date of grant.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The weighted-average forfeiture rates for the years ended December 31, 2016, 2015 and 2014 were based on historical data.

### **Options**

There were no Options granted during the years ended December 31, 2016, 2015 and 2014. Options granted to officers and employees under the Plan generally have a 10-year term, vesting 25% immediately and 25% on each of the first three anniversaries of the grant date. Options granted to non-employee directors under the Plan generally have a 10-year term and vest and become exercisable immediately on the grant date.

### **Restricted Stock Awards**

Under the provisions of the Plan, Ultimate may, at the discretion of the Compensation Committee or the Board, grant restricted stock awards ("Restricted Stock Awards") to officers, employees and non-employee directors. The shares of Common Stock issued under Restricted Stock Awards are subject to certain vesting requirements and restrictions on transfer. During the years ended December 31, 2016, 2015 and 2014, we granted Restricted Stock Awards for 453,023, 579,320 and 235,000 shares, respectively, of Common Stock to officers and employees and we granted Restricted Stock Awards for 9,815, 9,910 and 10,375 shares, respectively, of Common Stock to non-employee directors. Compensation expense for Restricted Stock Awards is measured based on the closing market price of our Common Stock at the date of grant and is recognized on a straight-line basis over the vesting period. Holders of Restricted Stock Awards have all rights of a stockholder including the right to vote the shares and receive all dividends and other distributions paid or made with respect thereto during the vesting period. Each Restricted Stock Award granted to officers and employees vest in three equal annual installments of 33-1/3% of the number of Restricted Stock Unit Awards on the anniversary of the date of grant thereof, subject to the grantee's continued employment with Ultimate or any of its subsidiaries on each such vesting date and subject further to accelerated vesting in the event of a change in control of Ultimate, death or disability, the termination of employment by Ultimate without cause. Each Restricted Stock Award granted to non-employee directors becomes vested on the fourth anniversary of the respective date of grant, subject to the grantee's continued board services on each such vesting date and subject further to accelerated vesting in the event of a change in control of Ultimate, death or disability, the termination of employment by Ultimate without cause or, in the case of a non-employee director, at cessation of his board services at the end of his term. Included in our consolidated statements of income for the years ended December 31, 2016, 2015 and 2014 was \$79.0 million, \$56.3 million and \$23.3 million, respectively, of non-cash stock-based compensation expense (which includes amounts capitalized associated with an internal-use development project) for Restricted Stock Awards.

## Restricted Stock Unit Awards

Ultimate may, at the discretion of the Compensation Committee, make Awards of stock units or restricted stock units under the Plan (“Restricted Stock Unit Awards”) to certain officers and employees. A Restricted Stock Unit Award is a grant of a number of hypothetical share units with respect to shares of Common Stock that are subject to vesting and transfer restrictions and conditions under a restricted stock unit award agreement. The value of each unit is equal to the fair value of one share of Common Stock on any applicable date of determination. The payment with respect to each unit under a Restricted Stock Unit Award may be made, at the discretion of the Compensation Committee, (i) in a number of shares of our Common Stock equal to the number of Restricted Stock Units becoming vested, (ii) in cash, in an amount equal to the fair market value of a share of our Common Stock on the vesting date multiplied by the number of restricted stock units becoming vested on such date or (iii) in a combination of both. The grantee of a Restricted Stock Unit Award does not have any rights as a stockholder with respect to the shares subject to a Restricted Stock Unit Award until such time as shares of Common Stock are delivered to the grantee pursuant to the terms of the related stock unit award agreement.

Restricted Stock Unit Awards vest in three equal annual installments of 33-1/3% of the number of Restricted Stock Unit Awards on each of the first three anniversaries of the date of grant thereof, subject to the participant’s continued employment with Ultimate or any of its subsidiaries on each such vesting date and subject further to accelerated vesting in the event of a change in control of Ultimate, death or disability, the termination of employment by Ultimate without cause and shall be payable as described above, provided, however, that if any such anniversary is not a date on which our Common Stock is traded on NASDAQ, then the vesting date shall be the last such trading day immediately preceding such anniversary; and provided further, however, that if the Chief Financial Officer (“CFO”) of Ultimate should determine that any such anniversary falls within a period during which the participant is prohibited from trading Ultimate’s Common Stock under our stock trading policy, the CFO shall so advise the participant in writing and the vesting date shall be the date as of which the CFO has determined that such period has ended.

There were 363,458, 241,235 and 207,000 Restricted Stock Unit Awards granted to employees during the years ended December 31, 2016, 2015 and 2014, respectively. Non-cash stock-based compensation expense for Restricted Stock Unit Awards is measured based on the fair market value of our Common Stock on the date of grant and recognized on a straight-line basis over the vesting period. Included in Ultimate’s consolidated statements of operations for the years ended December 31, 2016, 2015 and 2014 was \$38.8 million, \$29.2 million and \$22.9 million, respectively, of non-cash stock-based compensation expense (which includes amounts capitalized associated with an internal-use development project) for Restricted Stock Unit Awards.

## Option, Restricted Stock and Restricted Stock Unit Activity

The following table summarizes Option activity for the years ended December 31, 2014, 2015 and 2016, as follows (in thousands, except per share amounts and years):

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2013.....	1,032	\$ 24.69		
Granted .....	—	—		
Exercised .....	(310)	20.05		
Forfeited or expired .....	—	—		
Outstanding and exercisable at December 31, 2014.....	722	\$ 26.68	2.6	\$ 86,758
Outstanding at December 31, 2014.....	722	\$ 26.68		
Granted .....	—	—		
Exercised .....	(189)	24.85		
Forfeited or expired .....	(1)	14.36		
Outstanding and exercisable at December 31, 2015.....	532	\$ 27.36	1.8	\$ 89,373
Outstanding at December 31, 2015.....	532	\$ 27.36		
Granted .....	—	—		
Exercised .....	(188)	24.79		
Forfeited or expired .....	—	—		
Outstanding and exercisable at December 31, 2016.....	344	\$ 28.76	1.1	\$ 52,797

The aggregate intrinsic value of Options in the table above represents total pretax intrinsic value (i.e., the difference between the closing price of our Common Stock on the last trading day of the reporting period and the exercise price, times the number of shares) that would have been received by the Option holders had all Option holders exercised their Options on December 31, 2016. The amount of the aggregate intrinsic value changes, based on the fair value of our Common Stock. Total intrinsic value of Options exercised during the years ended December 31, 2016, 2015 and 2014 was \$32.0 million, \$28.7 million and \$44.6 million, respectively. There were no Options vested during the years ended December 31, 2014, 2013 and 2012. All options granted under the Plan and the Prior Plan are fully vested as of December 31, 2016.

The following table summarizes Restricted Stock and Restricted Stock Unit Award activity for the years ended December 31, 2014, 2015 and 2016, as follows (in thousands, except per share amounts):

	Restricted Stock Awards		Restricted Stock Unit Awards	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2013 .....	968	\$ 91.28	501	\$ 88.58
Granted .....	245	152.39	207	157.64
Vested .....	—	—	—	—
Released .....	(153)	40.38	(242)	80.00
Forfeited or expired .....	—	—	(22)	115.18
Outstanding at December 31, 2014 .....	1,060	\$ 112.77	444	\$ 124.07
Granted .....	589	169.52	241	169.89
Vested .....	—	—	—	—
Released .....	(283)	86.91	(233)	109.79
Forfeited or expired .....	—	—	(17)	147.24
Outstanding at December 31, 2015 .....	1,366	\$ 142.61	435	\$ 156.18
Granted .....	463	168.94	363	173.28
Vested .....	—	—	—	—
Released .....	(668)	122.37	(214)	145.47
Forfeited or expired .....	—	—	(22)	170.36
Outstanding at December 31, 2016 .....	1,161	\$ 164.77	562	\$ 170.73

As of December 31, 2016, \$120.1 million of total unrecognized compensation cost related to non-vested Restricted Stock Awards is expected to be recognized over a weighted average period of 1.57 years. As of December 31, 2016, \$62.9 million of total unrecognized compensation costs related to non-vested Restricted Stock Unit Awards is expected to be recognized over a weighted average period of 1.80 years.

The following table summarizes information with respect to Options outstanding and Options exercisable under the Plan at December 31, 2016:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number	Weighted Average Remaining Contractual Term (Years)	Weighted-Average Exercise Price	Number	Weighted Average Exercise Price
\$14.72—\$27.02 .....	60,052	0.84	\$ 20.40	60,052	\$ 20.40
\$28.41—\$28.41 .....	127,977	1.10	28.41	127,977	28.41
\$30.34—\$30.34 .....	34,125	0.56	30.34	34,125	30.34
\$32.39—\$32.39 .....	72,385	1.57	32.39	72,385	32.39
\$32.54—\$34.89 .....	49,225	1.12	33.47	49,225	33.47
\$14.72—\$34.89 .....	343,764	1.10	\$ 28.76	343,764	\$ 28.76

## Board Compensation

Each non-employee director of Ultimate receives compensation for serving on the Board, payable exclusively in the form of Restricted Stock Awards granted under the Plan.

Under the Plan, (i) each non-employee director was granted a restricted stock award of 400 shares of Common Stock for each regular meeting of the Board attended during each quarter of 2014, 2015 and 2016 and (ii) each of the Chairmen of the Audit Committee, Compensation Committee and Nominating Committee was granted a restricted stock award of 50 shares of

Common Stock for attendance at each regular meeting of the Committee during each quarter of 2014, 2015 and 2016 that he chaired.

In addition, in 2016, 2015 and 2014 each non-employee director was granted, for each fiscal quarter during which he served, a restricted stock award of that number of shares of Common Stock equal to the quotient of \$12,500 divided by the closing price of the Common Stock on NASDAQ on the date of grant, which is the effective date of the grant determined by the Board for each such quarter, rounded down to the closest full number of shares. Under the arrangement as amended, the date of grant shall not be a date prior to the date of the Board’s determination of the same and such restricted stock awards shall vest on the fourth anniversary of the date of grant, subject to accelerated vesting in the event of a director’s death, disability, cessation of service or the end of his term or the occurrence of a change of control of Ultimate.

The following table summarizes information about Restricted Stock Awards granted by us to non-employee directors in exchange for director related services rendered for 2016, 2015 and 2014:

Year	Market Value of Restricted Stock Awards Granted	Number of Restricted Stock Awards Granted
2014 .....	\$ 164.87	2,625
	118.03	2,625
	132.23	2,570
	152.59	2,555
2015 .....	\$ 160.92	2,535
	163.99	2,480
	183.19	2,440
	203.94	2,455
2016 .....	\$ 156.12	2,550
	191.67	2,425
	210.29	2,445
	210.59	2,395

The non-cash compensation expense, recognized in the consolidated statements of income related to the Restricted Stock Awards granted to non-employee directors, including the chairmen of the Audit, Compensation and Nominating Committees, determined pursuant to the application of ASC 718 for the years ended December 31, 2016, 2015 and 2014, was \$1,839,000, \$1,757,000 and \$1,652,000, respectively, and is included in general and administrative expenses in the consolidated statements of income. The non-cash stock-based expense amounts are included in the non-cash stock-based compensation expense for restricted stock awards in the consolidated statements of operations.

**Common Stock**

The holders of Common Stock are entitled to one vote per share for each share held of record on all matters submitted to a vote of the stockholders.



## 16. Commitments and Contingencies

### Operating Leases

We lease corporate office space and certain equipment under non-cancelable operating lease agreements expiring at various dates. Total rent expense under these agreements was \$16.7 million, \$13.1 million and \$8.5 million for the years ended December 31, 2016, 2015 and 2014, respectively. Future minimum annual rental commitments related to these leases are as follows as of December 31, 2016 (in thousands):

Year	Amount
2017 .....	\$ 14,425
2018 .....	11,599
2019 .....	10,447
2020 .....	9,843
2021 .....	9,332
Thereafter.....	4,723
	<u>\$ 60,369</u>

### Litigation

From time-to-time, Ultimate is involved in litigation relating to claims arising out of its operations in the normal course of business. We are not currently a party to any legal proceedings the adverse outcome of which, individually or in the aggregate, could reasonably be expected to have a material adverse effect on our operating results or financial condition.

## 17. Related Party Transactions

For the years ending December 31, 2016, 2015 and 2014, we had no related party transactions.

## 18. Employee Benefit Plan

Ultimate provides retirement benefits for eligible employees, as defined, through a defined contribution plan that is qualified under Section 401(k) of the Internal Revenue Code (the "401(k) Plan"). Contributions to the 401(k) Plan, which are made at the sole discretion of Ultimate, were \$10.5 million, \$7.2 million and \$5.5 million for the years ended December 31, 2016, 2015 and 2014, respectively.

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

None.

## Item 9A. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

Ultimate carried out an evaluation, under the supervision and with the participation of Ultimate's management, including the Chief Executive Officer (the "CEO") and the Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of Ultimate's disclosure controls and procedures as of the end of the period covered by this Form 10-K pursuant to Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, Ultimate's management, including the CEO and CFO, concluded that, as of December 31, 2016, Ultimate's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in Ultimate's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Ultimate's disclosure controls and procedures were designed to provide reasonable assurance as to the achievement of these objectives. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and thus has inherent limitations. Therefore, even those systems determined to be effective can only provide reasonable assurance as to the achievement of their objectives.

### Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act). Internal control over financial reporting is a process

designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016. In making this assessment, our management used the criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the results of this assessment, our management has concluded that, as of December 31, 2016, our internal control over financial reporting was effective. However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and, even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation.

KPMG LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this Form 10-K, has issued an attestation report on Ultimate's internal control over financial reporting as of December 31, 2016, which is included below on this Form 10-K.

#### **Changes in Internal Control Over Financial Reporting**

There have been no changes during the fourth quarter of 2016 in Ultimate's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, Ultimate's internal control over financial reporting.

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
The Ultimate Software Group, Inc.:

We have audited The Ultimate Software Group, Inc.'s (the Company) internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Ultimate Software Group, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 24, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

February 24, 2017  
Fort Lauderdale, Florida  
Certified Public Accountants

## Item 9B. Other Information

None.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

The executive officers (Messrs. Scott Scherr, Marc D. Scherr, Mitchell K. Dauerman, Adam Rogers, Greg Swick, Robert Manne and Chris Phenicie), directors and other key employees of Ultimate, and their ages as of February 18, 2017, are as follows:

<u>Name</u>	<u>Age</u>	<u>Position(s)</u>
Scott Scherr.....	64	Chairman of the Board, President and Chief Executive Officer
Marc D. Scherr.....	59	Vice Chairman of the Board and Chief Operating Officer
Mitchell K. Dauerman .....	59	Executive Vice President, Chief Financial Officer and Treasurer
Adam Rogers .....	42	Senior Vice President, Chief Technology Officer
Greg Swick .....	53	Senior Vice President, Chief Enterprise Sales Officer
Robert Manne .....	63	Senior Vice President, General Counsel
Chris Phenicie.....	45	Senior Vice President, Chief Mid-Market Sales Officer
James A. FitzPatrick, Jr.....	67	Director
Alois T. Leiter.....	51	Director
LeRoy A. Vander Putten .....	82	Director
Rick A. Wilber.....	70	Director
Robert A. Yanover.....	80	Director
Julie Dodd.....	47	Senior Vice President, Chief Services Officer
Bill Hicks.....	51	Senior Vice President, Chief Relationship Officer
Jody Kaminsky .....	42	Senior Vice President, Marketing
Vivian Maza.....	55	Senior Vice President, Chief People Officer and Secretary

Scott Scherr has served as President and a director of Ultimate since its inception in April 1996 and has been Chairman of the Board and Chief Executive Officer of Ultimate since September 1996. Mr. Scherr is also a member of the Executive Committee of the Board of Directors (the “Board”). In 1990, Mr. Scherr founded The Ultimate Software Group, Ltd. (the “Partnership”), the business and operations of which were assumed by Ultimate in 1998. Mr. Scherr served as President of the Partnership’s general partner from the inception of the Partnership until its dissolution in March 1998. From 1979 until 1990, he held various positions at ADP, a payroll services company, where his titles included Vice President of Operations and Sales Executive. Prior to joining ADP, Mr. Scherr operated Management Statistics, Inc., a data processing service bureau founded by his father, Reuben Scherr, in 1959. He is the brother of Marc Scherr, the Vice Chairman of the Board of Ultimate and the father-in-law of Adam Rogers, Senior Vice President, Chief Technology Officer.

Marc D. Scherr has been a director of Ultimate since its inception in April 1996 and has served as Vice Chairman since July 1998 and as Chief Operating Officer since October 2003. Mr. Scherr is also a member of the Executive Committee of the Board. Mr. Scherr became an executive officer of Ultimate effective March 1, 2000. Mr. Scherr served as a director of Gerschel & Co., Inc., a private investment firm from January 1992 until March 2000. In December 1995, Mr. Scherr co-founded Residential Company of America, Ltd. (“RCA”), a real estate firm, and served as President of its general partner until March 2000. Mr. Scherr also served as Vice President of RCA’s general partner from its inception in August 1993 until December 1995. From 1990 to 1992, Mr. Scherr was a real estate pension fund advisor at Aldrich, Eastman & Waltch. Previously, he was a partner in the Boston law firm of Fine & Ambrogne. Mr. Scherr is the brother of Scott Scherr, Chairman of the Board, President and Chief Executive Officer of Ultimate.

Mitchell K. Dauerman has served as Executive Vice President of Ultimate since April 1998 and as Chief Financial Officer and Treasurer of Ultimate since September 1996. From 1979 to 1996, Mr. Dauerman held various positions with KPMG LLP, an accounting firm, serving as a Partner in the firm from 1988 to 1996. Mr. Dauerman is a Certified Public Accountant.

Adam Rogers has served as Senior Vice President, Chief Technology Officer since February 6, 2007. Mr. Rogers served as Senior Vice President, Development from December 2002 to February 6, 2007. From July 2001 to December 2002,

Mr. Rogers served as Vice President of Engineering. From May 1997 to July 2001, Mr. Rogers held various positions in Ultimate's research and development organization, including Director of Technical Support from October 1998 to November 1999 and Director of Web Development from November 1999 to July 2001. Mr. Rogers is the son-in-law of Scott Scherr, Chairman of the Board, President and Chief Executive Officer of Ultimate.

Greg Swick has served as Senior Vice President since January 2001 and as Chief Enterprise Sales Officer since February 6, 2007. Mr. Swick served as Vice President and General Manager of the PEO Division of Ultimate's sales organization from November 1999 to January 2001. From February 1998 to November 1999, Mr. Swick was Director of Sales, Northeast Division. Prior to joining Ultimate, Mr. Swick was President of The Ultimate Software Group of New York and New England, G.P., a reseller of Ultimate Software which was acquired by Ultimate in March 1998. From 1987 to 1994, Mr. Swick held various positions with ADP, where the most recent position was Area Vice President — ADP Dealer Services Division.

Robert Manne has served as Senior Vice President, General Counsel since February 2004 and served as Vice President, General Counsel from May 1999 through January 2004. Prior to joining Ultimate, Mr. Manne was an attorney and partner of Becker & Poliakoff, P.A., an international law firm, since 1978. In addition to administering the Litigation Department of the law firm, Mr. Manne was a permanent member of the firm's executive committee which was responsible for law firm operations. Mr. Manne has performed legal services for Ultimate since its inception.

Chris Phenicie has served as Senior Vice President and Chief Mid-Market Sales Officer since January 2009 and served as Vice President of Workplace Sales from April 2007 until January 2009. From January 2000 to April 2007, Mr. Phenicie served as Strategic Account Manager for Ultimate. From July 1997 to January 2000, Mr. Phenicie held various sales positions with ADP, the most recent of which position was Sales Manager.

James A. FitzPatrick, Jr. has served as a director of Ultimate since July 2000 and is Chairman of the Nominating Committee of the Board and is a member of the Compensation Committee of the Board since February 2014. Mr. FitzPatrick is, and since June 2012 has been, a partner in the law firm Hogan Lovells US LLP. Mr. FitzPatrick was a partner in the law firm Dewey & LeBoeuf LLP and its predecessor firms from January 1983 until May 2012 and was an associate from September 1974 until January 1983.

Al Leiter has served as director of Ultimate since October 2006 and is a member of the Compensation Committee and the Nominating Committee of the Board. Mr. Leiter was a three-time Major League Baseball World Champion and two-time All-Star pitcher formerly with the New York Yankees, New York Mets, Toronto Blue Jays, and Florida Marlins, and has been an official spokesperson for Ultimate since 2002. Mr. Leiter has served as a television commentator for the Yankees Entertainment and Sports Network since 2006 and as an analyst with MLB Network since January 2009. Mr. Leiter is president and founder of Leiter's Landing, a charitable organization formed in 1996. Mr. Leiter has served on the Executive Committee of New York City's official tourism marketing organization, NYC & Company, since 2000 and is on the Board of Directors of America's Camp, a legacy organization of the Twin Towers Fund, on which he also served as a board member.

LeRoy A. Vander Putten has served as a director of Ultimate since October 1997, is Chairman of the Compensation Committee of the Board and is a member of the Audit Committee of the Board. Mr. Vander Putten served as the Executive Chairman of The Insurance Center, Inc., a holding company for 14 insurance agencies, from October 2001 until January 2006 at which time the company was sold. Previously, he served as the Chairman of CORE Insurance Holdings, Inc., a member of the GE Global Insurance Group, engaged in the underwriting of casualty reinsurance, from August 2000 to August 2001. From April 1998 to August 2000, he served as Chairman of Trade Resources International Holdings, Ltd., a corporation engaged in trade finance for exporters from developing countries. From January 1988 until May 1997, Mr. Vander Putten was Chairman and Chief Executive Officer of Executive Risk Inc., a specialty insurance holding company. From August 1982 to January 1988, Mr. Vander Putten served as Vice President and Deputy Treasurer of The Aetna Life and Casualty Company, an insurance company.

Rick A. Wilber has served as a director of Ultimate since October 2002 and is a member of the Audit Committee, a member of the Compensation Committee, and a member of the Nominating Committee of the Board. Mr. Wilber formerly served on Ultimate's Board of Directors from October 1997 through May 2000. Mr. Wilber served as the President of Lynn's Hallmark Cards, which owned and operated a number of Hallmark Card stores, from 1995 until 2013, at which time Mr. Wilber retired. Mr. Wilber has served as a director of Synergy Resource Corporation, an oil and gas exploration company, since October 2008. Mr. Wilber was a co-founder of Champs Sports Shops and served as its President from 1974 to 1984. He served on the Board of Royce Laboratories, a pharmaceutical concern, from 1990 until April 1997, when Royce Laboratories was sold to Watson Pharmaceuticals, Inc., a pharmaceutical concern.

Robert A. Yanover has served as a director of Ultimate since January 1997 and is Chairman of the Audit Committee and a member of the Compensation Committee of the Board. Mr. Yanover founded Computer Leasing Corporation of Michigan, a private leasing company, in 1975 and served as its President from its founding until 2007, at which time Mr.

Yanover retired. Mr. Yanover also founded Lason, Inc., a corporation specializing in the imaging business, and served as Chairman of the Board from its inception in 1987 until 1998 and as a director through February 2001.

Each officer serves at the discretion of the Board and holds office until his or her successor is elected and qualified or until his or her earliest resignation or removal. Messrs. Scott Scherr and Al Leiter serve on the Board in the class whose term expires at the Annual Meeting of Stockholders ("Annual Meeting") in 2016. Messrs. LeRoy A. Vander Putten and Robert A. Yanover serve on the Board in the class whose term expires at the Annual Meeting in 2017. Messrs. Marc D. Scherr, James A. FitzPatrick, Jr. and Rick A. Wilber serve on the Board in the class whose term expires at the Annual Meeting in 2018.

Julie Dodd has served as Senior Vice President and Chief Services Officer since October 2013, responsible for all support and implementation services provided by the Company to its customers. Ms. Dodd served as Senior Vice President and General Manager, Mid-Market Services, from April 2010 until January 2014 and served as Vice President and General Manager of Mid-Market Operations from January 2009 until April 2010. From October 2007 to December 2008, Ms. Dodd served as the Director of Product Strategy, with primary focus on the UltiPro Mid-Market product offering. Prior to joining Ultimate, Ms. Dodd provided consulting services for large scale implementations, operations efficiencies projects and new cloud product launches for various service providers. From 2002 to 2005, Ms. Dodd held various executive positions with Ceridian Corporation, an information technology company, supporting their small and mid-market solutions.

Bill Hicks has served as Senior Vice President and Chief Relationship Officer since October 2013. Mr. Hicks served as Senior Vice President of Shared Services and Chief Information Officer since April 2005. Mr. Hicks served as Vice President and Chief Information Officer from February 2004 through March 2005. From 1993 until February 2004, Mr. Hicks held various positions in the management of technologies for Precision Response Corporation, a wholly-owned subsidiary of Interactive Corporation and a provider of call centers and on-line commerce customer care services, including Chief Information Officer and Senior Vice President of Technology from August 2000 until February 2004.

Jody Kaminsky has served as Senior Vice President of Marketing since April 2010. Ms. Kaminsky served as Vice President of Marketing from July 2008 until April 2010. Ms. Kaminsky served as Vice President of Marketing Operations from July 2005 to June 2008, as Director of Strategic Marketing from December 2002 through June 2005, and in various other Marketing and Communications positions from November 1999 through November 2002. Prior to that, Ms. Kaminsky held various positions with General Electric's GE Information Services division from April 1997 through August 1999, including Manager of Communications and Community Relations.

Vivian Maza has served as Senior Vice President, Chief People Officer and Secretary of Ultimate since February 2004 and served as Vice President, People from January 1998 through January 2004. Ms. Maza has served as Secretary of Ultimate since September 1996. Prior to that, Ms. Maza served as the Office Manager of Ultimate from its organization in April 1996 and of the Partnership from its inception in 1990 until April 1996. Ms. Maza is an HR Generalist and holds a Professional in Human Resources (PHR) certification from the Society for Human Resource Management (SHRM) association. From 1985 to 1990, Ms. Maza was a systems analyst for the Wholesale Division of ADP.

## **Code of Ethics**

Ultimate has adopted a Code of Ethics within the meaning of Item 406 of Regulation S-K of the Exchange Act. Ultimate's Code of Ethics applies to its principal executive officer, principal financial officer and principal accounting officer. A copy of Ultimate's Code of Ethics is posted on Ultimate's website at [www.ultimatesoftware.com](http://www.ultimatesoftware.com). In the event that Ultimate makes any amendments to, or grants any waiver from, a provision of the Code of Ethics that requires disclosure under Item 5.05 of Form 8-K, Ultimate will post such information on its website.

## **Corporate Governance**

In 2013 the Board formed a Nominating Committee. The primary function of the Nominating Committee is to recommend director-nominees to be considered for election or appointment by the Board. Ultimate has established a Nominating Committee Charter that sets forth the Nominating Committee's principal duties and responsibilities. This charter is available on our website.

When considering potential director candidates, the Board considers, and the Nominating Committee will consider, the candidate's independence (as mandated by the NASDAQ rules), character, judgment, age, skills, financial literacy, and experience in the context of the needs of Ultimate and the Board. Other information required by this item is incorporated herein by reference to the information set forth in Ultimate's Proxy Statement for the Annual Meeting in 2017 under the heading "Corporate Governance, Board Meetings and Committees of the Board." In 2016, Ultimate did not pay any fees to a third party to assist in identifying or evaluating potential nominees.

The Nominating Committee and the Board will consider director candidates recommended by Ultimate’s stockholders in a similar manner as those recommended by members of management or other directors.

**Other Information**

The information required by this item is incorporated herein by reference to the information set forth in Ultimate’s Proxy Statement for the Annual Meeting in 2017 under the headings “Section 16(a) Beneficial Ownership Reporting Compliance” and “Corporate Governance, Board Meetings and Committees of the Board-Audit Committee.”

**Item 11. Executive Compensation**

The information required by this item is incorporated herein by reference to the information in Ultimate’s Proxy Statement for the 2017 Annual Meeting under the headings “Executive Compensation Policy,” “Director Compensation” and “Compensation Committee Report.”

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

The information set forth in this item is incorporated herein by reference to the information in Ultimate’s Proxy Statement for the 2017 Annual Meeting under the heading “Security Ownership of Certain Beneficial Owners and Management.”

Equity Compensation Plan Information.

The following table summarizes information related to Ultimate’s equity compensation plans as of December 31, 2016:

<b>Equity Compensation Plan Information</b>			
<b>Plan Category</b>	<b>(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>(c) Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column ( a ))</b>
Equity compensation plans approved by security holders .....	343,764	\$ 28.76	1,162,546
Equity compensation plans not approved by security holders ..	—	—	—
Total .....	<u>343,764</u>	<u>\$ 28.76</u>	<u>1,162,546</u>

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

The information required by this item is incorporated herein by reference to the information in Ultimate’s Proxy Statement for the 2017 Annual Meeting under the headings “Certain Relationships and Related Transactions,” “Compensation Committee Interlocks and Insider Participation” and “Corporate Governance, Board Meetings and Committees of the Board.”

**Item 14. Principal Accountant Fees and Services**

The information required by this item is incorporated herein by reference to the information in Ultimate’s Proxy Statement for the 2017 Annual Meeting under the heading “KPMG LLP Fees.”

**PART IV**

**Item 15. Exhibits and Financial Statement Schedule**

(a) Documents filed as part of this Form 10-K:

1. The following consolidated financial statements of Ultimate, together with the report thereon, of KPMG LLP, our Independent Registered Public Accounting Firm, are included in Part II, Item 8, of this Form 10-K:

Consolidated Balance Sheets as of December 31, 2016 and 2015

Consolidated Statements of Income for the Years Ended December 31, 2016, 2015 and 2014

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016, 2015 and 2014

## Notes to Consolidated Financial Statements

## 3. Exhibits

Number	Description
3.1	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.4 to the Registration Statement on Form S-1 (File 333-47881), initially filed March 13, 1998 (the "Registration Statement"))
3.2	Certificate of Designations of Series A Junior Preferred Stock (incorporated by reference to Exhibit 2 to Ultimate's Current Report on Form 8-K dated October 23, 1998)
3.3	Amended and Restated Bylaws (incorporated herein by reference to Exhibit 3.2 to Ultimate's Current Report on Form 8-K dated February 6, 2013)
4.1	Form of Certificate for the Common Stock, par value \$0.01 per share (incorporated by reference to Exhibit 4.1 to the Registration Statement)
4.2	Form of Warrant for Common Stock (incorporated by reference to Exhibit 4.4 to Ultimate's Registration Statement on Form S-3 (File No. 333-107527), initially filed July 31, 2003)
4.3	Amended and Restated Rights Agreement, dated as of August 26, 2008, between Ultimate and Computershare Trust Company, N.A., as Rights Agent. The Rights Agreement includes the Form of Certificate of Designations of Series A Junior Preferred Stock as Exhibit A, the Form of Rights Certificate as Exhibit B and the Summary of Rights as Exhibit C (incorporated by reference to Exhibit 4.1 to Ultimate's Current Report on Form 8-K dated September 2, 2008).
10.1	Shareholders Rights Agreement, dated June 6, 1997 among Ultimate and certain stockholders named therein (incorporated by reference to Exhibit 10.1 to the Registration Statement)
10.2	Commercial Office Lease by and between ROHO Ultimate, LTD. II, a Florida limited partnership ("Landlord") and Ultimate dated May 23, 2001 (incorporated by reference to Exhibit 10.32 to Ultimate's Annual Report on Form 10-K dated March 15, 2006)
10.3	Weston Town Center South Office Building Lease between South Office Building-DLB, LLC, a Florida Limited Liability Company, South Office Building Bagtrust, LLC, a Florida Limited Liability Company, and South Office Building-BJB, LLC, a Florida Limited Liability Company, and Ultimate and Weston Common Area LTD., dated August 18, 2005 (incorporated by reference to Exhibit 10.35 to Ultimate's Annual Report on Form 10-K, dated March 15, 2006)
10.4	Galleria Atlanta office lease agreement between Galleria 600, LLC, a Delaware limited liability company, and Ultimate, dated April 27, 2006 (incorporated by reference to Exhibit 10.36 to Ultimate's Quarterly Report on Form 10-Q, dated August 8, 2006)
10.5	Lease of Office Space by and between OMERS Realty Corporation CPP Investment Board Real Estate Holdings Inc., and The Ultimate Group of Canada, Inc., dated August 22, 2006 (incorporated by reference to Exhibit 10.37 to Ultimate's Quarterly Report on Form 10-Q, dated November 8, 2006)
10.6	Indemnity Agreement between OMERS Realty Corporation, CPP Investment Board Real Estate Holdings, Inc., and Ultimate dated August 22, 2006 (incorporated by reference to Exhibit 10.38 to Ultimate's Quarterly Report on Form 10-Q, dated November 8, 2006)
10.7	Amendment to Lease by and between ROHO Ultimate, Ltd. I ("Landlord") and Ultimate Group. Inc. ("Tenant") for Demised premises at 2000 Ultimate Way, Weston, FL 33326 (the "Premises") dated February 15, 2000 (incorporated by reference to Exhibit 10.39 to Ultimate's Annual Report on Form 10-K, dated March 16, 2007)
10.8	First Amendment to Lease between Galleria 600, LLC ("Landlord") and Ultimate, dated August 18, 2006 (incorporated by reference to Exhibit 10.42 to Ultimate's Annual Report on Form 10-K, dated March 16, 2007)
10.9	Amended and Restated 2005 Equity and Incentive Plan (incorporated by reference to Exhibit 10.1 to Ultimate's Current Report on Form 8-K, dated May 17, 2016) †
10.10	Commercial lease between Weston Office, LLC ("Landlord") and Ultimate, dated January 18, 2008 (incorporated by reference to Exhibit 10.45 to Ultimate's Annual Report on Form 10-K, dated March 13, 2008)
10.11	Commercial lease between AGF Woodfield Owner, L.L.C., ("Landlord") and Ultimate, dated October 31, 2008 (incorporated by reference to Exhibit 10.47 to Ultimate's Annual Report on Form 10-K, dated March 2, 2009)
10.12	Commercial lease between 300 Galleria Parkway Associates, L.P., ("Landlord") and Ultimate, dated September 8, 2009 (incorporated by reference to Exhibit 10.33 to Ultimate's Quarterly Report on Form 10-Q, dated November 9, 2009)



- 10.13 Commercial lease between RT Twenty-Sixth Pension Properties Limited (“Landlord”) and Ultimate, dated September 4, 2009 (incorporated by reference to Exhibit 10.34 to Ultimate’s Quarterly Report on Form 10-Q, dated November 9, 2009)
- 10.14 Master Space Agreement between Quality Technology Services Miami LLC and Ultimate, dated June 1, 2009 (incorporated by reference to Exhibit 10.1 to Ultimate’s Quarterly Report on Form 10-Q, dated August 9, 2010) ✓
- 10.15 Master Space Agreement between Quality Technology Services Metro LLC and Ultimate, dated June 1, 2009 (incorporated by reference to Exhibit 10.2 to Ultimate’s Quarterly Report on Form 10-Q, dated August 9, 2010) ✓
- 10.16 Service Order Form between Verizon Canada Ltd. and Ultimate, dated September 23, 2009 (incorporated by reference to Exhibit 10.3 to Ultimate’s Quarterly Report on Form 10-Q, dated August 9, 2010) ✓
- 10.17 Amended and Restated Change in Control Bonus Plan for Executive Officers dated April 26, 2010 (incorporated by reference to Exhibit 10.1 to Ultimate’s Current Report on Form 8-K, dated February 2, 2016) †
- 10.18 Commercial lease between 2000 Main Street Associates, LLC (“Landlord”) and Ultimate, dated November 3, 2010 (incorporated by reference to Exhibit 10.54 to Ultimate’s Annual Report on Form 10-K, dated March 1, 2011)
- 10.19 Commercial lease between Micari Holdings, LLC (“Landlord”) and Ultimate, dated November 5, 2010 (incorporated by reference to Exhibit 10.55 to Ultimate’s Annual Report on Form 10-K, dated March 1, 2011)
- 10.20 Commercial lease between Galleria 400, LLC (“Landlord”) and Ultimate, dated December 29, 2010 (incorporated by reference to Exhibit 10.56 to Ultimate’s Annual Report on Form 10-K, dated March 1, 2011)
- 10.21 Commercial lease between AG/LPC Griffin Towers, L.P., (“Landlord”) and Ultimate, dated February 23, 2011 (incorporated by reference to Exhibit 10.1 to Ultimate’s Quarterly Report on Form 10-Q, dated May 10, 2011)
- 10.22 Commercial lease between TCS-CB LLC, (“Landlord”) and Ultimate, dated July 25, 2012 (incorporated by reference to Exhibit 10.1 to Ultimate’s Quarterly Report on Form 10-Q, dated November 9, 2012)
- 10.23 License and Master Services Agreement between IO Phoenix One, LLC and Ultimate, dated February 27, 2012, as amended (incorporated by reference to Exhibit 10.2 to Ultimate’s Quarterly Report on Form 10-Q, dated November 9, 2012) ✓
- 10.24 Master Services Agreement between Savvis Communications Canada, Inc. and Ultimate, dated April 30, 2013 (incorporated by reference to Exhibit 10.1 to Ultimate’s Quarterly Report on Form 10-Q, dated August 8, 2013) ✓
- 10.25 Service Schedule between Savvis Communications Canada, Inc. and Ultimate, dated April 30, 2013 (incorporated by reference to Exhibit 10.2 to Ultimate’s Quarterly Report on Form 10-Q, dated August 8, 2013) ✓
- 10.26 Colocation Services Service Level Attachment between Savvis Communications Canada, Inc. and Ultimate, dated April 30, 2013 (incorporated by reference to Exhibit 10.3 to Ultimate’s Quarterly Report on Form 10-Q, dated August 8, 2013) ✓
- 10.27 Commercial lease between DP Weston Pointe III, LLC, (“Landlord”) and Ultimate, dated December 8, 2014 (incorporated by reference to Exhibit 10.27 to Ultimate’s Annual Report on Form 10-K, dated February 27, 2015)
- 10.28 Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1 to Ultimate’s Quarterly Report on Form 10-Q, dated August 5, 2016) †
- 10.29 Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.2 to Ultimate’s Quarterly Report on Form 10-Q, dated August 5, 2016) †
- 21.1 Subsidiaries of the Registrant \*
- 23.1 Consent of Independent Registered Public Accounting Firm \*
- 31.1 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended \*
- 31.2 Certification Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended \*
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended \*
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended \*
- 101.1 Interactive Data Files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of December 31, 2016 and 2015, (ii) Consolidated Statements of Income for the Years Ended December 31, 2016, 2015 and 2014, (iii) Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016, 2015 and 2014; (iv) Consolidated Statements of Stockholders’ Equity for the Years Ended December 31, 2016, 2015 and 2014; (v) Consolidated Statements of Cash Flows for the Years Ended December 31, 2016, 2015 and 2014; and (vi) Notes to Consolidated Financial Statements.

\* Filed herewith.

† Indicates management contract or compensatory plan, contract or arrangement.

✓ Confidential treatment has been granted with respect to certain portions of this exhibit pursuant to Rule 24b-2 of the Securities and Exchange Act of 1934, as amended, and such portions have been omitted and filed separately with the SEC.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

THE ULTIMATE SOFTWARE GROUP, INC.

By: /s/ Mitchell K. Dauerman  
Mitchell K. Dauerman  
Executive Vice President, Chief Financial Officer and Treasurer

Date: February 24, 2017

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

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ Scott Scherr</u> Scott Scherr	President, Chief Executive Officer and Chairman of the Board	February 24, 2017
<u>/s/ Mitchell K. Dauerman</u> Mitchell K. Dauerman	Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	February 24, 2017
<u>/s/ Marc D. Scherr</u> Marc D. Scherr	Vice Chairman of the Board and Chief Operating Officer	February 24, 2017
<u>/s/ James A. FitzPatrick, Jr.</u> James A. FitzPatrick, Jr.	Director	February 24, 2017
<u>/s/ LeRoy A. Vander Putten</u> LeRoy A. Vander Putten	Director	February 24, 2017
<u>/s/ Rick Wilber</u> Rick Wilber	Director	February 24, 2017
<u>/s/ Robert A. Yanover</u> Robert A. Yanover	Director	February 24, 2017
<u>/s/ Alois T. Leiter</u> Alois T. Leiter	Director	February 24, 2017

**Subsidiaries of the Registrant**

**Name**

The Ultimate Software Group of Canada, Inc.

The Ultimate Software Group of Asia, PTE. LTD.

**Jurisdiction of Incorporation**

Ontario, Canada

Singapore

**Consent of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

The Ultimate Software Group, Inc.:

We consent to the incorporation by reference (i) in the registration statements (No. 333-107527 and No. 333-115894) on Forms S-3 of The Ultimate Software Group, Inc. (the Company) and (ii) the registration statements (No. 333-91332, No. 333-125076, No. 333-142972, No. 333-161201, and No. 333-183984) on Forms S-8 of the Company of our report dated February 24, 2017, with respect to the consolidated balance sheets of The Ultimate Software Group, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and the effectiveness of internal control over financial reporting as of December 31, 2016, which report appears in the December 31, 2016 Annual Report on Form 10-K of the Company.

/s/ KPMG LLP

Fort Lauderdale, Florida  
February 24, 2017  
Certified Public Accountants

**CERTIFICATION**

I, Scott Scherr, certify that:

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

Date: February 24, 2017

/s/ Scott Scherr

Chief Executive Officer

## CERTIFICATION

I, Mitchell K. Dauerman, certify that:

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

Date: February 24, 2017

/s/ Mitchell K. Dauerman

Chief Financial Officer

(Principal Financial and Accounting Officer)

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

I, Scott Scherr, Chief Executive Officer of The Ultimate Software Group, Inc., hereby certify to the best of my knowledge and belief that this Annual Report on Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and that the information contained in this Annual Report on Form 10-K fairly represents, in all material respects, the financial condition and results of operations of The Ultimate Software Group, Inc.

/s/ Scott Scherr  
Chief Executive Officer  
February 24, 2017

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

I, Mitchell K. Dauerman, Chief Financial Officer of The Ultimate Software Group, Inc., hereby certify to the best of my knowledge and belief that this Annual Report on Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and that the information contained in this Annual Report on Form 10-K fairly represents, in all material respects, the financial condition and results of operations of The Ultimate Software Group, Inc.

/s/ Mitchell K. Dauerman  
Chief Financial Officer  
February 24, 2017