

CBIZ, Inc.  
Form 10-Q  
August 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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 1-32961

CBIZ, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation

or organization)

6050 Oak Tree Boulevard, South, Suite 500, Cleveland, Ohio  
(Address of principal executive offices)

22-2769024  
(I.R.S. Employer

Identification No.)

44131  
(Zip Code)

(Registrant's telephone number, including area code) 216-447-9000

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(Former name, former address and former fiscal year, if changed since last report)

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:

|  |                              |
|--|------------------------------|
| Class of Common Stock                    | Outstanding at July 31, 2017 |
| Common Stock, par value \$0.01 per share | 54,818,911                   |

CBIZ, INC. AND SUBSIDIARIES

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## CBIZ, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS (Unaudited)

(In thousands)

|  | June 30,<br>2017 | December 31,<br>2016 |
|--|------------------|----------------------|
| <b>ASSETS</b>                                      |                  |                      |
| Current assets:                                    |                  |                      |
| Cash and cash equivalents                          | \$ 1,161         | \$ 3,494             |
| Restricted cash                                    | 34,924           | 27,880               |
| Accounts receivable, net                           | 218,317          | 175,354              |
| Other current assets                               | 25,489           | 21,407               |
| Current assets before funds held for clients       | 279,891          | 228,135              |
| Funds held for clients                             | 148,704          | 213,457              |
| Total current assets                               | 428,595          | 441,592              |
| Non-current assets:                                |                  |                      |
| Property and equipment, net                        | 23,728           | 19,450               |
| Goodwill and other intangible assets, net          | 618,846          | 584,401              |
| Assets of deferred compensation plan               | 76,251           | 69,912               |
| Notes receivable                                   | 1,198            | 1,227                |
| Other non-current assets                           | 2,048            | 2,006                |
| Total non-current assets                           | 722,071          | 676,996              |
| Total assets                                       | \$ 1,150,666     | \$ 1,118,588         |
| <b>LIABILITIES</b>                                 |                  |                      |
| Current liabilities:                               |                  |                      |
| Accounts payable                                   | \$ 62,013        | \$ 45,772            |
| Income taxes payable                               | 6,946            | 1,048                |
| Accrued personnel costs                            | 36,265           | 45,221               |
| Notes payable                                      | 1,210            | 1,060                |
| Contingent purchase price liability                | 18,396           | 16,322               |
| Other current liabilities                          | 16,604           | 16,169               |
| Current liabilities before client fund obligations | 141,434          | 125,592              |
| Client fund obligations                            | 148,814          | 213,855              |
| Total current liabilities                          | 290,248          | 339,447              |
| Non-current liabilities:                           |                  |                      |
| Bank debt  | 210,600          | 191,400              |
| Debt issuance costs                                | (1,090 )         | (1,351 )             |
| Total long-term debt                               | 209,510          | 190,049              |
| Notes payable                                      | 1,696            | 1,721                |
| Income taxes payable                               | 4,612            | 4,426                |
| Deferred income taxes, net                         | 4,464            | 3,545                |
| Deferred compensation plan obligations             | 76,251           | 69,912               |
| Contingent purchase price liability                | 24,830           | 17,387               |
| Other non-current liabilities                      | 15,693           | 12,080               |

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|  |             |              |
|--|-------------|--------------|
| Total non-current liabilities              | 337,056     | 299,120      |
| Total liabilities                          | 627,304     | 638,567      |
| <b>STOCKHOLDERS' EQUITY</b>                |             |              |
| Common stock                               | 1,296       | 1,282        |
| Additional paid in capital                 | 668,542     | 655,629      |
| Retained earnings                          | 330,797     | 294,925      |
| Treasury stock                             | (476,986 )  | (471,311 )   |
| Accumulated other comprehensive loss       | (287 )      | (504 )       |
| Total stockholders' equity                 | 523,362     | 480,021      |
| Total liabilities and stockholders' equity | \$1,150,666 | \$ 1,118,588 |

See the accompanying notes to the consolidated financial statements

## CBIZ, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

(In thousands, except per share data)

|   | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30,<br>2017   | 2016      | June 30,<br>2017 | 2016      |
| Revenue   | \$211,016          | \$197,015 | \$452,475        | \$421,253 |
| Operating expenses                                  | 188,120            | 173,996   | 380,886          | 352,113   |
| Gross margin  | 22,896             | 23,019    | 71,589           | 69,140    |
| Corporate general and administrative expenses       | 9,232              | 8,346     | 18,000           | 18,591    |
| Operating income                                    | 13,664             | 14,673    | 53,589           | 50,549    |
| Other (expense) income:                             |                    |           |                  |           |
| Interest expense                                    | (1,692 )           | (1,733 )  | (3,209 )         | (3,259 )  |
| Gain on sale of operations, net                     | 23                 | 50        | 45               | 151       |
| Other income, net                                   | 3,764              | 703       | 6,501            | 2,850     |
| Total other income (expense), net                   | 2,095              | (980 )    | 3,337            | (258 )    |
| Income from continuing operations before income tax |                    |           |                  |           |
| expense   | 15,759             | 13,693    | 56,926           | 50,291    |
| Income tax expense                                  | 4,343              | 5,306     | 20,484           | 20,106    |
| Income from continuing operations                   | 11,416             | 8,387     | 36,442           | 30,185    |
| Loss from discontinued operations, net of tax       | (418 )             | (258 )    | (570 )           | (288 )    |
| Net income  | \$10,998           | \$8,129   | \$35,872         | \$29,897  |
| Earnings (loss) per share:                          |                    |           |                  |           |
| Basic:  |                    |           |                  |           |
| Continuing operations                               | \$0.21             | \$0.16    | \$0.68           | \$0.58    |
| Discontinued operations                             | (0.01 )            | —         | (0.01 )          | (0.01 )   |
| Net income  | \$0.20             | \$0.16    | \$0.67           | \$0.57    |
| Diluted:  |                    |           |                  |           |
| Continuing operations                               | \$0.20             | \$0.16    | \$0.66           | \$0.57    |
| Discontinued operations                             | (0.01 )            | —         | (0.01 )          | (0.01 )   |
| Net income  | \$0.19             | \$0.16    | \$0.65           | \$0.56    |
| Basic weighted average shares outstanding           | 53,968             | 52,031    | 53,632           | 51,802    |
| Diluted weighted average shares outstanding         | 55,831             | 53,079    | 55,530           | 52,901    |
| Comprehensive Income:                               |                    |           |                  |           |
| Net income  | \$10,998           | \$8,129   | \$35,872         | \$29,897  |
| Other comprehensive income (loss), net of tax       | 37                 | (130 )    | 217              | (441 )    |
| Comprehensive income                                | \$11,035           | \$7,999   | \$36,089         | \$29,456  |

See the accompanying notes to the consolidated financial statements

## CBIZ, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)

(In thousands)

|                               | Issued<br>Common<br>Shares | Treasury<br>Shares | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Totals     |
|-------------------------------|----------------------------|--------------------|-----------------|----------------------------------|----------------------|-------------------|---|------------|
| December 31, 2016             | 128,191                    | 74,147             | \$ 1,282        | \$ 655,629                       | \$ 294,925           | \$(471,311)       | \$ (504 )                                     | \$ 480,021 |
| Net income                    | —                          | —                  | —               | —                                | 35,872               | —                 | —   | 35,872     |
| Other comprehensive<br>income | —                          | —                  | —               | —                                | —                    | —                 | 217   | 217        |
| Share repurchases             | —                          | 400                | —               | —                                | —                    | (5,675 )          | —   | (5,675 )   |
| Restricted stock              | 294                        | —                  | 3               | (3 )                             | —                    | —                 | —   | —          |
| Stock options                 |                            |                    |                 |                                  |                      |                   |   |            |
| exercised                     | 805                        | —                  | 8               | 5,641                            | —                    | —                 | —   | 5,649      |
| Share-based<br>compensation   | —                          | —                  | —               | 2,790                            | —                    | —                 | —   | 2,790      |
| Business acquisitions         | 312                        | —                  | 3               | 4,485                            | —                    | —                 | —   | 4,488      |
| June 30, 2017                 | 129,602                    | 74,547             | \$ 1,296        | \$ 668,542                       | \$ 330,797           | \$(476,986)       | \$ (287 )                                     | \$ 523,362 |

See the accompanying notes to the consolidated financial statements



## CBIZ, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

|  | Six Months Ended<br>June 30, |           |
|--|------------------------------|-----------|
|  | 2017                         | 2016      |
| <b>Cash flows from operating activities:</b>   |                              |           |
| Net income   | \$35,872                     | \$29,897  |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                              |           |
| Loss from discontinued operations, net of tax  | 570                          | 288       |
| Gain on sale of operations, net  | (45 )                        | (151 )    |
| Depreciation and amortization expense  | 11,279                       | 10,682    |
| Amortization of discount on notes and deferred financing costs                           | 262                          | 262       |
| Amortization of discount on contingent earnout liability                                 | 276                          | 106       |
| Bad debt expense, net of recoveries  | 2,439                        | 2,205     |
| Adjustment to contingent earnout liability   | (1,032 )                     | (714 )    |
| Deferred income taxes  | 776                          | 894       |
| Employee stock awards  | 2,790                        | 2,842     |
| Excess tax benefits from share based payment arrangements                                | (2,678 )                     | (673 )    |
| <b>Changes in assets and liabilities, net of acquisitions and divestitures:</b>          |                              |           |
| Restricted cash  | (7,044 )                     | (6,998 )  |
| Accounts receivable, net   | (40,997 )                    | (36,439 ) |
| Other assets   | (263 )                       | (2,950 )  |
| Accounts payable   | 14,376                       | 19,268    |
| Income taxes payable   | 8,762                        | 7,766     |
| Accrued personnel costs  | (9,598 )                     | (6,616 )  |
| Other liabilities  | 1,989                        | 2,163     |
| Operating cash flows provided by continuing operations                                   | 17,734                       | 21,832    |
| Operating cash flows (used in) provided by discontinued operations                       | (540 )                       | 428       |
| Net cash provided by operating activities  | 17,194                       | 22,260    |
| <b>Cash flows from investing activities:</b>   |                              |           |
| Business acquisitions and purchases of client lists, net of cash acquired                | (26,561 )                    | (34,004 ) |
| Purchases of client fund investments   | (11,788 )                    | (4,963 )  |
| Proceeds from the sales and maturities of client fund investments                        | 4,375                        | 4,747     |
| Proceeds from sales of divested operations   | 45                           | 93        |
| Increase in funds held for clients   | 72,417                       | 3,649     |
| Additions to property and equipment, net   | (6,749 )                     | (1,837 )  |
| Collection of notes receivable   | 18                           | 119       |
| Net cash provided by (used in) investing activities                                      | 31,757                       | (32,196 ) |
| <b>Cash flows from financing activities:</b>   |                              |           |
| Proceeds from bank debt  | 308,000                      | 278,000   |
| Payment of bank debt   | (288,800)                    | (248,300) |
| Payment on early extinguishment of convertible debt                                      | —                            | (760 )    |
| Payment for acquisition of treasury stock  | (5,675 )                     | (7,828 )  |
| Decrease in client funds obligations   | (65,041 )                    | (3,504 )  |
| Proceeds from exercise of stock options  | 5,649                        | 3,529     |

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|  |           |          |
|--|-----------|----------|
| Payment of contingent consideration for acquisitions and client list purchases | (5,211 )  | (4,110 ) |
| Excess tax benefit from exercise of stock awards                               | —         | 673      |
| Payment of notes payable   | (206 )    | (116 )   |
| Deferred financing costs   | —         | (6 )     |
| Net cash (used In) provided by financing activities                            | (51,284 ) | 17,578   |
| Net (decrease) increase in cash and cash equivalents                           | (2,333 )  | 7,642    |
| Cash and cash equivalents at beginning of year                                 | 3,494     | 850      |
| Cash and cash equivalents at end of period                                     | \$1,161   | \$8,492  |

See the accompanying notes to the consolidated financial statements

## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of CBIZ, Inc. and its subsidiaries (“CBIZ,” the “Company,” “we,” “us,” or “our”) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by the accounting principles generally accepted in the United States (“GAAP”) for complete financial statements.

All intercompany accounts and transactions have been eliminated in consolidation. The accompanying unaudited consolidated financial statements do not reflect the operations or accounts of variable interest entities as the impact is not material to the financial condition, results of operations or cash flows of CBIZ.

These interim unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, all adjustments of a normal recurring nature considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2017.

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management’s estimates and assumptions include, but are not limited to, estimates of collectability of accounts receivable and unbilled revenue, the realizability of goodwill and other intangible assets, the fair value of certain assets, the valuation of stock options in determining compensation expense, estimates of accrued liabilities (such as incentive compensation, self-funded health insurance accruals, legal reserves, income tax uncertainties and contingent purchase price obligations), the provision for income taxes and the realizability of deferred tax assets. Management’s estimates and assumptions are derived from and are continually evaluated based upon available information, judgment and experience. Changes in circumstances could cause actual results to differ materially from those estimates.

Refer to Note 1, Organization and Summary of Significant Accounting Policies, in our Annual Report on Form 10-K for the year ended December 31, 2016 for a description of revenue recognition policies.

## Note 2. Accounts Receivable, Net

Accounts receivable, net, at June 30, 2017 and December 31, 2016 were as follows (in thousands):

|   | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| Trade accounts receivable                 | \$153,156        | \$ 132,880           |
| Unbilled revenue, at net realizable value | 77,987           | 55,982               |

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|                                 |           |            |
|---------------------------------|-----------|------------|
| Total accounts receivable       | 231,143   | 188,862    |
| Allowance for doubtful accounts | (12,826 ) | (13,508 )  |
| Accounts receivable, net        | \$218,317 | \$ 175,354 |

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## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

## Note 3. Goodwill and Other Intangible Assets, Net

The components of goodwill and other intangible assets, net, at June 30, 2017 and December 31, 2016 were as follows (in thousands):

|   | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| Goodwill                                  | \$526,984        | \$ 487,484           |
| Intangible assets:                        |                  |                      |
| Client lists                              | 175,397          | 172,343              |
| Other intangible assets                   | 8,703            | 7,994                |
| Total intangible assets                   | 184,100          | 180,337              |
| Total goodwill and intangibles assets     | 711,084          | 667,821              |
| Accumulated amortization:                 |                  |                      |
| Client lists                              | (88,754 )        | (80,560 )            |
| Other intangible assets                   | (3,484 )         | (2,860 )             |
| Total accumulated amortization            | (92,238 )        | (83,420 )            |
| Goodwill and other intangible assets, net | \$618,846        | \$ 584,401           |

## Note 4. Depreciation and Amortization

Depreciation and amortization expense for property and equipment and intangible assets for the three and six months ended June 30, 2017 and 2016 was as follows (in thousands):

|   | Three Months<br>Ended |         | Six Months Ended |          |
|---|-----------------------|---------|------------------|----------|
|   | June 30,<br>2017      | 2016    | June 30,<br>2017 | 2016     |
| Operating expenses                            | \$5,546               | \$5,322 | \$11,089         | \$10,452 |
| Corporate general and administrative expenses | 92                    | 115     | 190              | 230      |
| Total depreciation and amortization expense   | \$5,638               | \$5,437 | \$11,279         | \$10,682 |

## Note 5. Debt and Financing Arrangements

At June 30, 2017, our primary financing arrangement was the \$400 million unsecured credit facility discussed below, which provides us with the capital necessary to meet our working capital needs as well as the flexibility to continue with our strategic initiatives, including business acquisitions and share repurchases. In addition to the discussion below, refer to our Annual Report on Form 10-K for the year ended December 31, 2016 for additional details of our debt and financing arrangements.

Bank Debt

We have a \$400 million unsecured credit facility with Bank of America as agent for a group of eight participating banks that matures in July 2019. The balance outstanding under the credit facility was \$210.6 million and \$191.4 million at June 30, 2017 and December 31, 2016, respectively.

Interest rates for the six months ended June 30, 2017 and 2016 were as follows:

|                          | Six Months    |       |
|--------------------------|---------------|-------|
|                          | Ended         |       |
|                          | June 30,      |       |
|                          | 2017          | 2016  |
| Weighted average rates   | 2.60%         | 2.38% |
| Range of effective rates | 2.19% - 4.75% | 3.50% |

## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

We have approximately \$140 million of available funds under the credit facility at June 30, 2017, net of outstanding letters of credit of \$2.3 million. The credit facility provides us with operating flexibility and funding to support seasonal working capital needs and other strategic initiatives such as acquisitions and share repurchases. As of June 30, 2017, we were in compliance with our debt covenants.

Available funds under the credit facility are based on a multiple of earnings before interest, taxes, depreciation and amortization as defined in the credit facility, and are reduced by letters of credit, license bonds, other indebtedness and outstanding borrowings under the credit facility.

Under the credit facility, loans are charged an interest rate consisting of a base rate or Eurodollar rate plus an applicable margin, letters of credit are charged based on the same applicable margin, and a commitment fee is charged on the unused portion of the credit facility.

## Interest Expense

During the three and six months ended June 30, 2017 and 2016, we recognized interest expense as follows (in thousands):

|                        | Three Months<br>Ended<br>June 30, |          | Six Months<br>Ended<br>June 30, |          |
|------------------------|-----------------------------------|----------|---------------------------------|----------|
|                        | 2017                              | 2016     | 2017                            | 2016     |
| Credit facility (1)    | \$ 1,692                          | \$ 1,731 | \$ 3,209                        | \$ 3,251 |
| 2006 Notes (2)         | —                                 | 2        | —                               | 8        |
| Total interest expense | \$ 1,692                          | \$ 1,733 | \$ 3,209                        | \$ 3,259 |

(1) Components of interest expense related to the credit facility include amortization of deferred financing costs, commitment fees and line of credit fees.

(2) During the second quarter of 2016, we redeemed the remaining 3.125% Convertible Senior Subordinated Notes (the "2006 Notes") for \$750 thousand in cash plus accrued interest under an optional early redemption provision.

## Note 6. Commitments and Contingencies

## Letters of Credit and Guarantees

We provide letters of credit to landlords (lessors) of our leased premises in lieu of cash security deposits, which totaled \$2.3 million at both June 30, 2017 and December 31, 2016. In addition, we provide license bonds to various state agencies to meet certain licensing requirements. The amount of license bonds outstanding was \$2.5 million and \$2.3 million at June 30, 2017 and December 31, 2016, respectively.

## Legal Proceedings

In 2010, CBIZ, Inc. and its subsidiary, CBIZ MHM, LLC (fka CBIZ Accounting, Tax & Advisory Services, LLC) (the “CBIZ Parties”), were named as defendants in lawsuits filed in the U.S. District Court for the District of Arizona and the Superior Court for Maricopa County, Arizona. The federal court case is captioned Robert Facciola, et al v. Greenberg Traurig LLP, et al, and the state court cases are captioned Victims Recovery, LLC v. Greenberg Traurig LLP, et al, Roger Ashkenazi, et al v. Greenberg Traurig LLP, et al, Mary Marsh, et al v. Greenberg Traurig LLP, et al; and ML Liquidating Trust v. Mayer Hoffman McCann PC, et al. Prior to these suits CBIZ MHM, LLC was named as a defendant in Jeffrey C. Stone v. Greenberg Traurig LLP, et al.

These lawsuits arose out of the bankruptcy of Mortgages Ltd., a mortgage lender to developers in the Phoenix, Arizona area. Various other professional firms and individuals not related to the Company were also named defendants in these lawsuits. The lawsuits asserted claims for, among others things, violations of the Arizona Securities Act, common law fraud, and negligent misrepresentation, and sought to hold the CBIZ Parties vicariously liable for Mayer Hoffman’s conduct as Mortgage Ltd.’s auditor, as either a statutory control person under the Arizona Securities Act or a joint venturer under Arizona common law.



## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

With the exception of claims being pursued by two plaintiffs from the Ashkenazi lawsuit (“Baldino Group”), all other related matters have been dismissed or settled without payment by the CBIZ Parties. The Baldino Group’s claims, which allege damages of approximately \$16 million, are currently stayed as to the CBIZ Parties and Mayer Hoffman, and no trial date has been set.

On September 16, 2016, CBIZ, Inc. and its subsidiary CBIZ Benefits & Insurance Services, Inc. (“CBIZ Benefits”) were named as defendants in a lawsuit filed in the U.S. District Court for the Western District of Pennsylvania. The federal court case is brought by UPMC, d/b/a University of Pittsburgh Medical Center, and a health system it acquired, UPMC Altoona (formerly, Altoona Regional Health System). The lawsuit asserts professional negligence, breach of contract, and negligent misrepresentation claims against CBIZ, CBIZ Benefits and a former employee of CBIZ Benefits in connection with actuarial services provided by CBIZ Benefits to Altoona Regional Health System. The complaint seeks damages in an amount of no less than \$142 million.

We cannot predict the outcome of the above matters or estimate the possible loss or range of possible loss, if any. Although the proceedings are subject to uncertainties inherent in the litigation process and the ultimate disposition of these proceedings is not presently determinable, we intend to vigorously defend these cases.

In addition to those items disclosed above, we are, from time to time, subject to claims and suits arising in the ordinary course of business.

## Note 7. Financial Instruments

## Bonds

We held corporate and municipal bonds with par values totaling \$50 million and \$42.4 million at June 30, 2017 and December 31, 2016, respectively. All bonds are investment grade and are classified as available-for-sale. These bonds have maturity or callable dates ranging from July 2017 through May 2022, and are included in “Funds held for clients – current” in the accompanying Consolidated Balance Sheets based on our intent and ability to sell these investments at any time under favorable conditions. The following table summarizes our bond activity for the six months ended June 30, 2017 and the twelve months ended December 31, 2016 (in thousands):

|                                   | Six<br>Months     | Twelve<br>Months      |
|-----------------------------------|-------------------|-----------------------|
|                                   | Ended<br>June 30, | Ended<br>December 31, |
|                                   | 2017              | 2016                  |
| Fair value at beginning of period | \$44,573          | \$ 43,142             |

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|                                     |          |           |
|-------------------------------------|----------|-----------|
| Purchases                           | 11,788   | 11,355    |
| Redemptions                         | (940 )   | (2,900 )  |
| Maturities                          | (3,435 ) | (6,878 )  |
| Increase (decrease) in bond premium | 204      | (106 )    |
| Fair market value adjustment        | 251      | (40 )     |
| Fair value at end of period         | \$52,441 | \$ 44,573 |

Interest Rate Swaps

We do not purchase or hold any derivative instruments for trading or speculative purposes. We utilize interest rate swaps to manage interest rate risk exposure associated with our floating-rate debt under the credit facility. Under these interest rate swap contracts, we receive cash flows from counterparties at variable rates based on the London Interbank Offered Rate (“LIBOR”) and pay the counterparties a fixed rate. See our Annual Report on Form 10-K for the year ended December 31, 2016 for further discussion on our interest rate swaps.

During the second quarter of 2017, we entered into an additional interest rate swap with a notional value of \$20 million at a fixed interest rate of 1.77% maturing in 5 years.

## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

The following table summarizes our outstanding interest rate swaps and their classification in the accompanying Consolidated Balance Sheets at June 30, 2017 and December 31, 2016 (in thousands):

|                         | June 30, 2017 |       |                          |
|-------------------------|---------------|-------|--------------------------|
|                         | Notional      | Fair  |                          |
|                         |               | Value |                          |
|                         | Amount        | (1)   | Balance Sheet Location   |
| Interest rate swaps (2) | \$70,000      | \$629 | Other non-current assets |
| Interest rate swaps (2) | \$10,000      | \$13  | Other current assets     |

  

|                         | December 31, 2016 |       |                          |
|-------------------------|-------------------|-------|--------------------------|
|                         | Notional          | Fair  |                          |
|                         |                   | Value |                          |
|                         | Amount            | (1)   | Balance Sheet Location   |
| Interest rate swaps (2) | \$50,000          | \$525 | Other non-current assets |
| Interest rate swaps (2) | \$10,000          | \$4   | Other current assets     |

(1) Refer to Note 8, Fair Value Measurements, for additional disclosures regarding fair value measurements.

(2) Under the terms of the interest rate swaps, we pay interest at a fixed rate of interest plus applicable margin as stated in the agreement, and receive interest that varies with the one-month LIBOR. The notional value, fixed rate of interest and maturity date of each interest rate swap is (i) \$10 million – 0.885% - November 2017, (ii) \$15 million – 1.155% - November 2018, (iii) \$25 million – 1.300% - October 2020, (iv) \$10 million – 1.120% - February 2021 and (v) \$20 million – 1.770% - May 2022.

The following table summarizes the effects of the interest rate swaps on the accompanying Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and 2016 (in thousands):

|                    | (Loss) Gain<br>Recognized | Gain (Loss)<br>Reclassified |
|--------------------|---------------------------|-----------------------------|
|                    | in AOCL,<br>net of tax    | from AOCL<br>into Expense   |
|                    | Three<br>Months<br>Ended  | Three<br>Months<br>Ended    |
|                    | June 30,<br>2017          | June 30,<br>2016            |
| Interest rate swap | \$ (22)                   | \$ (110)                    |

|                    | Six Months<br>Ended<br>June 30,<br>2017 |         | Six Months<br>Ended<br>June 30,<br>2016 |       |
|--------------------|---|---------|---|-------|
| Interest rate swap | \$71                                    | \$(763) | \$100                                   | \$215 |

Note 8. Fair Value Measurements

The following table summarizes our assets and liabilities at June 30, 2017 and December 31, 2016 that are measured at fair value on a recurring basis subsequent to initial recognition and indicates the fair value hierarchy of the valuation techniques utilized by us to determine such fair value (in thousands):

|                                       |       | June 30,   | December 31, |
|---------------------------------------|-------|------------|--------------|
|                                       | Level | 2017       | 2016         |
| Deferred compensation plan assets     | 1     | \$76,251   | \$ 69,912    |
| Corporate and municipal bonds         | 1     | \$52,441   | \$ 44,573    |
| Interest rate swaps                   | 2     | \$642      | \$ 529       |
| Contingent purchase price liabilities | 3     | \$(43,226) | \$ (33,709 ) |

The carrying amounts of our cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of these instruments. The carrying value of bank debt approximates fair value as the interest rate on the bank debt is variable and approximates current market rates. As a result, the fair value measurement of our bank debt is considered to be Level 2.

## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

During the six months ended June 30, 2017 and 2016, there were no transfers between the valuation hierarchy Levels 1, 2 and 3. The following table summarizes the change in Level 3 fair values of our contingent purchase price liabilities for the six months ended June 30, 2017 and 2016 (pre-tax basis) (in thousands):

|   | 2017       | 2016       |
|---|------------|------------|
| Beginning balance – January 1                       | \$(33,709) | \$(24,817) |
| Additions from business acquisitions                | (17,526)   | (15,088)   |
| Settlement of contingent purchase price liabilities | 7,253      | 6,349      |
| Change in fair value of contingencies               | 1,032      | 714        |
| Change in net present value of contingencies        | (276 )     | (106 )     |
| Ending balance – June 30                            | \$(43,226) | \$(32,948) |

## Contingent Purchase Price Liabilities

Contingent purchase price liabilities arise from business acquisitions and are classified as Level 3 due to the utilization of a probability weighted discounted cash flow approach to determine the fair value of the contingency.

A contingent liability is established (“Additions from business acquisitions” in the table above) for each acquisition that has a contingent purchase price component extending over a term of two to six years. These liabilities are reviewed quarterly and adjusted if necessary. Refer to Note 12, Acquisitions, for further discussion of contingent purchase price liabilities.

•The significant unobservable input used in the fair value measurement of the contingent purchase price liabilities is the future performance of the acquired business.

- oThe future performance of the acquired business directly impacts the contingent purchase price that is paid to the seller; thus, performance that exceeds estimates may result in a higher payout, and a performance under estimates may result in a lower payout (“Settlement of contingent purchase price liabilities” in the table above).
- oChanges in the expected amount of potential payouts are recorded as adjustments to the initial contingent purchase price liability, with the same amount being recorded in the accompanying Consolidated Statements of Comprehensive Income (“Change in fair value of contingencies” and “Change in net present value of contingencies” in the table above). The change in fair value of contingencies also includes an adjustment for the change in share price of CBIZ common stock for the portion of future contingent consideration to be settled in stock.

## Note 9. Other Comprehensive Income (Loss)

The following table is a summary of other comprehensive income (loss) and discloses the tax impact of each component of other comprehensive income (loss) for the three and six months ended June 30, 2017 and 2016 (in

thousands):

|  | Three<br>Months<br>Ended<br>June 30,<br>2017 |         | Six Months<br>Ended<br>June 30,<br>2016 |         |
|--|--|---------|---|---------|
| Net unrealized gain on available-for-sale              |  |         |   |         |
| securities, net of income taxes (1)                    | \$62   | \$112   | \$151                                   | \$343   |
| Net unrealized (loss) gain on interest rate swaps, net |  |         |   |         |
| of income taxes (2)                                    | (22)   | (231)   | 71                                      | (763)   |
| Foreign currency translation                           | (3 )   | (11 )   | (5 )                                    | (21 )   |
| Total other comprehensive income (loss)                | \$37   | \$(130) | \$217                                   | \$(441) |

(1) Net of income tax expense of \$41 and \$75 for the three months ended June 30, 2017 and 2016, respectively, and net of income tax expense of \$100 and \$167 for the six months ended June 30, 2017 and 2016, respectively.

(2) Net of income tax benefit of \$13 and \$136 for the three months ended June 30, 2017 and 2016, respectively, and net of income tax expense (benefit) of \$42 and (\$448) for the six months ended June 30, 2017 and 2016, respectively.

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## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Accumulated other comprehensive loss, net of tax, was approximately \$0.3 million and \$0.5 million at June 30, 2017 and December 31, 2016, respectively. Accumulated other comprehensive loss consisted of adjustments, net of tax, for unrealized gains and losses on available-for-sale securities and interest rate swaps, and foreign currency translation.

## Note 10. Employee Share Plans

Under our stock incentive plan, which expires in 2024, a maximum of 9.6 million stock options, shares of restricted stock or other stock-based compensation awards may be granted. Shares subject to award under this plan may be either authorized but unissued shares of CBIZ common stock or treasury shares. Compensation expense for stock-based awards recognized during the three and six months ended June 30, 2017 and 2016 was as follows (in thousands):

|  | Three Months<br>Ended<br>June 30, |         | Six Months<br>Ended<br>June 30, |         |
|--|-----------------------------------|---------|---------------------------------|---------|
|  | 2017                              | 2016    | 2017                            | 2016    |
| Stock options                          | \$524                             | \$564   | \$1,050                         | \$1,143 |
| Restricted stock awards                | 891                               | 869     | 1,740                           | 1,699   |
| Total stock-based compensation expense | \$1,415                           | \$1,433 | \$2,790                         | \$2,842 |

Stock award activity during the six months ended June 30, 2017 was as follows (in thousands, except per share data):

|                                  | Stock Options |                                    | Restricted Stock Awards |                                |
|----------------------------------|---------------|------------------------------------|-------------------------|--------------------------------|
|                                  | Number<br>of  | Weighted Average<br>Exercise Price | Number<br>of            | Weighted Average<br>Grant-Date |
|                                  | Options       | Per Share                          | Shares                  | Fair Value (1)                 |
| Outstanding at beginning of year | 4,376         | \$ 8.02                            | 827                     | \$ 9.14                        |
| Granted                          | 654           | \$ 15.54                           | 295                     | \$ 14.90                       |
| Exercised or released            | (805 )        | \$ 7.02                            | (393 )                  | \$ 8.61                        |
| Expired or canceled              | (6 )          | \$ 7.44                            | (1 )                    | \$ 8.36                        |
| Outstanding at June 30, 2017     | 4,219         | \$ 9.38                            | 727                     | \$ 11.76                       |
| Exercisable at June 30, 2017     | 2,370         | \$ 7.61                            |                         |                                |

(1) Represents weighted average market value of the shares; awards are granted at no cost to the recipients.

We utilized the Black-Scholes-Merton options-pricing model to determine the fair value of stock options on the date of grant. The fair value of stock options granted during the second quarter of 2017 was \$3.49. The following weighted average assumptions were utilized:

|                                  | Six<br>Months<br>Ended | June 30, |
|----------------------------------|------------------------|----------|
| Expected volatility (1)          | 22.22 %                |          |
| Expected option life (years) (2) | 4.61                   |          |
| Risk-free interest rate (3)      | 1.85 %                 |          |
| Expected dividend yield (4)      | 0.00 %                 |          |

(1) The expected volatility assumption was determined based upon the historical volatility of our stock price, using daily price intervals.

(2) The expected option life was determined based upon our historical data using a midpoint scenario, which assumes all options are exercised halfway between the expiration date and the weighted average time for the option to vest.



## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

- (3) The risk-free interest rate assumption was based upon zero-coupon U.S. Treasury bonds with a term approximating the expected life of the respective options.
- (4) The expected dividend yield assumption was determined in view of our historical and estimated dividend payouts. We do not expect to change our dividend payout policy in the foreseeable future.

## Note 11. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share from continuing operations for the three and six months ended June 30, 2017 and 2016 (in thousands, except per share data).

|   | Three Months<br>Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|---|-----------------------------------|----------|------------------------------|-----------|
|   | 2017                              | 2016     | 2017                         | 2016      |
| <b>Numerator:</b>                                     |                                   |          |                              |           |
| Income from continuing operations                     | \$ 11,416                         | \$ 8,387 | \$ 36,442                    | \$ 30,185 |
| <b>Denominator:</b>                                   |                                   |          |                              |           |
| <b>Basic</b>  |                                   |          |                              |           |
| Weighted average common shares outstanding            | 53,968                            | 52,031   | 53,632                       | 51,802    |
| <b>Diluted</b>  |                                   |          |                              |           |
| Stock options (1)                                     | 1,544                             | 814      | 1,524                        | 811       |
| Restricted stock awards (1)                           | 319                               | 229      | 374                          | 283       |
| Contingent shares (2)                                 | —                                 | 5        | —                            | 5         |
| Diluted weighted average common shares<br>outstanding | 55,831                            | 53,079   | 55,530                       | 52,901    |
| Basic earnings per share from continuing operations   | \$ 0.21                           | \$ 0.16  | \$ 0.68                      | \$ 0.58   |
| Diluted earnings per share from continuing operations | \$ 0.20                           | \$ 0.16  | \$ 0.66                      | \$ 0.57   |

- (1) A total of 0.5 million and 0.2 million share based awards were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2017, respectively, and a total of 1.7 million and 1.5 million share based awards were excluded from the calculation of diluted earnings per share for the three and six months ended June 30, 2016, respectively, as their effect would be anti-dilutive.
- (2) Contingent shares represent additional shares to be issued for purchase price earned by former owners of businesses acquired by us once future considerations have been met. Refer to Note 12, Acquisitions, for further details.

## Note 12. Acquisitions

2017

During the first half of 2017, we acquired substantially all of the assets of three businesses; CMF Associates, LLC (“CMF”), Slaton Insurance (“Slaton”) and Pacific Coastal Pension and Insurance Services, Inc. (“Pacific Coastal”). Aggregate consideration for these acquisitions consisted of approximately \$23.7 million in cash consideration, \$2 million in CBIZ common stock and \$17.5 million in contingent consideration.

Under the terms of these acquisition agreements, a portion of the purchase price is contingent on future performance of the business acquired. We have preliminarily determined that the fair value of the contingent consideration arrangements for these acquisitions was \$17.5 million, of which \$5.9 million was recorded in “Contingent purchase price liability – current” and \$11.6 million was recorded in “Contingent purchase price liability – non-current” in the accompanying Consolidated Balance Sheets at June 30, 2017.

Annualized revenue attributable to CMF, Slaton and Pacific Coastal is estimated to be approximately \$19.2 million, \$2.6 million, and \$1.4 million, respectively. Pro forma results of operations for these acquisitions have not been presented because the effects of the acquisitions were not significant to our results.

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## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

The acquisition of CMF, located in Philadelphia, Pennsylvania, was effective June 1, 2017. CMF provides various financial consulting, executive search and deal origination services. Operating results of CMF are reported in the Financial Services practice group. The acquisition of Slaton, located in West Palm Beach, Florida, was effective June 1, 2017. Slaton is a full service insurance brokerage firm offering clients a complete line of services including commercial lines, risk management and employee benefits. The acquisition of Pacific Coastal, located in Morgan Hill, California, was effective February 1, 2017. Pacific Coastal provides defined contribution third party administrative and consulting services. Operating results for both Slaton and Pacific Coastal are reported in the Benefits and Insurance practice group.

The preliminary estimated fair values of the assets acquired and the liabilities assumed during the six months ended June 30, 2017 are as follows (in thousands):

|                                | Six<br>Months<br>Ended<br>June 30,<br>2017 |
|--------------------------------|--|
| Cash                           | \$843                                      |
| Accounts receivable, net       | 4,338                                      |
| Property and equipment, net    | 24   |
| Other assets                   | 151  |
| Identifiable intangible assets | 3,115                                      |
| Current liabilities            | (4,716)                                    |
| Total identifiable net assets  | \$3,755                                    |
| Goodwill                       | 39,460                                     |
| Aggregate purchase price       | \$43,215                                   |

The goodwill of \$39.5 million arising from the acquisitions in the first half of 2017 primarily results from expected future earnings and cash flows from the existing management team, as well as the synergies created by the integration of the new business within the CBIZ organization, including cross-selling opportunities expected with our Financial Services and Benefits and Insurance practice groups, to help strengthen our existing service offerings and expand our market position.

## 2016

During the first half of 2016, we acquired substantially all of the non-attest assets of three businesses; Flex-Pay Business Services, Inc., (“Flex-Pay”), The Savitz Organization (“Savitz”) and Millimaki Eggert, L.L.P., (“Millimaki”). Aggregate consideration for these acquisitions consisted of approximately \$33 million in cash consideration, \$1.6 million in CBIZ common stock and \$15.1 million in contingent consideration.

Under the terms of these acquisition agreements, a portion of the purchase price is contingent on future performance of the business acquired. Utilizing a probability weighted income approach, we determined that the fair value of the contingent consideration arrangement for these acquisitions was \$15.1 million, of which \$4.4 million was recorded in “Contingent purchase price liability – current” and \$10.7 million was recorded in “Contingent purchase price liability – non-current” in the Consolidated Balance Sheets at June 30, 2016.

Annualized revenue attributable to Flex-Pay, Savitz and Millimaki is estimated to be approximately \$10 million, \$20 million, and \$2.4 million, respectively. Pro forma results of operations for these acquisitions have not been presented because the effects of the acquisitions were not significant to our results.

The acquisition of Flex-Pay, located in Winston-Salem, North Carolina, was effective June 1, 2016. Flex-Pay provides payroll processing, Affordable Care Act fulfillment and human resource solutions to more than 3,600 clients primarily in the Southeast. The acquisition of Savitz, headquartered in Philadelphia, Pennsylvania, with offices in Atlanta, Georgia, and Newton, Massachusetts, was effective April 1, 2016. Savitz is an employee retirement and health and welfare benefits firm that provides actuarial, consulting and administration outsourcing services. Operating results for both Flex-Pay and Savitz are reported in the Benefits and Insurance practice group. The acquisition of Millimaki, located in San Diego, California, was effective January 1, 2016. Millimaki provides professional tax, accounting, and financial services, with a specialty niche practice in the real estate sector, to closely held businesses, their owners, and mid-to-high net worth individuals. Operating results are reported in the Financial Services practice group.

## CBIZ, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

The estimated fair values of the assets acquired and the liabilities assumed during the six months ended June 30, 2016 are as follows (in thousands):

|                                | Six<br>Months<br><br>Ended<br>June 30,<br>2016 |
|--------------------------------|--|
| Cash                           | \$6  |
| Accounts receivable, net       | 5,313  |
| Funds held for clients         | 37,230   |
| Property and equipment, net    | 383  |
| Other assets                   | 172  |
| Identifiable intangible assets | 17,755   |
| Current liabilities            | (378 )   |
| Client fund obligations        | (37,230)                                       |
| Total identifiable net assets  | \$23,251                                       |
| Goodwill                       | 26,471   |
| Aggregate purchase price       | \$49,722                                       |

The goodwill of \$26.5 million arising from the acquisitions in the first half of 2016 primarily results from the same reasons as discussed above in the 2017 section.

## Client Lists

During the six months ended June 30, 2017, we purchased one client list which is reported in the Benefits and Insurance practice group for \$0.7 million of contingent consideration. During the same period in 2016, we purchased three clients lists, two of which are reported in the Benefits and Insurance practice group, and one in the Financial Services practice group. Total consideration for these client lists was \$0.2 million in cash consideration, \$1 million of guaranteed future consideration and \$0.7 million of contingent consideration.

## Change in Contingent Purchase Price Liability for Previous Acquisitions

During the first half of 2017 and 2016, we decreased the fair value of the contingent purchase price liability related to prior acquisitions by \$0.8 million and \$0.7 million, respectively. These changes in fair value are attributable to subsequent measurement adjustments based on projected future results of the acquired businesses, net present value adjustments and changes in the CBIZ common stock price. These adjustments are included in "Other income, net" in the accompanying Consolidated Statements of Comprehensive Income.

## Contingent Payments for Previous Acquisitions and Client Lists

We paid \$4.8 million in cash and issued approximately 177,000 shares of CBIZ common stock during the six months ended June 30, 2017 for previous acquisitions. For the first half of 2017, we also paid approximately \$0.4 million in cash for previous client list purchases. For the same period in 2016, we paid \$4.1 million in cash and issued approximately 220,000 shares of CBIZ common for previous acquisitions.

#### Note 13. Discontinued Operations and Divestitures

We will divest (through sale or closure) business operations that do not contribute to our long-term objectives for growth, or that are not complementary to our target service offerings and markets. Divestitures are classified as discontinued operations provided they meet the criteria as provided in FASB ASC Topic 205 “Presentation of Financial Statements — Discontinued Operations — Other Presentation Matters”.

#### Discontinued Operations

Revenue and results from operations of discontinued operations are separately reported as “Loss from discontinued operations, net of tax” in the accompanying Consolidated Statements of Comprehensive Income. During the first half of both 2017 and 2016, we did not discontinue the operations of any of our businesses.

CBIZ, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

Revenue and results from operations of discontinued operations for the three and six months ended June 30, 2017 and 2016 were as follows (in thousands):

|         | Three<br>Months<br>Ended<br>June 30,<br>2017 | 2016 | Six Months<br>Ended<br>June 30,<br>2017 | 2016 |
|---------|--|------|---|------|
| Revenue | \$ —   | \$   |   |      |