NGL Energy Partners LP
Form 10-Q
February 09, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended December 31, 2014

or

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

For the transition period from to

Commission File Number: 001-35172

NGL Energy Partners LP

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**27-3427920** (I.R.S. Employer Identification No.)
6120 South Yale Avenue **Suite 805** **Tulsa, Oklahoma** (Address of Principal Executive Offices)	**74136** (Zip code)

(918) 481-1119

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 x No o

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 (Section 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 x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

At February 2, 2015, there were 89,723,169 common units issued and outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

Forward-Looking Statements

This Quarterly Report on Form 10-Q (Quarterly Report) contains various forward-looking statements and information that are based on our beliefs and those of our general partner, as well as assumptions made by and information currently available to us. These forward-looking statements are identified as any statement that does not relate strictly to historical or current facts. When used in this Quarterly Report, words such as anticipate, believe, could, estimate, expect, forecast, goal, intend, may, plan, project, will, and similar expressio regarding our plans and objectives for future operations, are intended to identify forward-looking statements. Although we and our general partner believe that the expectations on which such forward-looking statements are based are reasonable, neither we nor our general partner can give assurances that such expectations will prove to be correct. Forward-looking statements are subject to a variety of risks, uncertainties and assumptions. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated, projected or expected. Among the key risk factors that impact our consolidated financial position and results of operations are:

- the prices for crude oil, natural gas, natural gas liquids, refined products, ethanol, and biodiesel;
- energy prices generally;
- the price of propane and distillates relative to the price of alternative and competing fuels;
- the price of gasoline relative to the price of corn, which impacts the price of ethanol;
- the general level of crude oil, natural gas, and natural gas liquids production;
- the general level of demand for crude oil, natural gas liquids, refined products, ethanol, and biodiesel;
- the availability of supply of crude oil, natural gas liquids, refined products, ethanol, and biodiesel;
- the level of crude oil and natural gas drilling and production in producing basins in which we have water treatment and disposal facilities;

- the ability to obtain adequate supplies of propane and distillates for retail sale in the event of an interruption in supply or transportation and the availability of capacity to transport propane and distillates to market areas;

- actions taken by foreign oil and gas producing nations;

- the political and economic stability of petroleum producing nations;

- the effect of weather conditions on supply and demand for crude oil, natural gas liquids, refined products, ethanol, and biodiesel;

- the effect of natural disasters, lightning strikes, or other significant weather events;

- availability of local, intrastate and interstate transportation infrastructure, including with respect to our truck, railcar, and barge transportation services;

- availability, price, and marketing of competitive fuels;

- the impact of energy conservation efforts on product demand;

- energy efficiencies and technological trends;

- governmental regulation and taxation;

- the impact of legislative and regulatory actions on hydraulic fracturing and on the treatment of flowback and produced water;

Table of Contents

- hazards or operating risks incidental to the transporting and distributing of petroleum products that may not be fully covered by insurance;
- the maturity of the crude oil and natural gas liquids industries and competition from other marketers;
- the loss of key personnel;
- the ability to hire drivers;
- the ability to renew contracts with key customers;
- the ability to maintain or increase the margins we realize for our terminal, barging, trucking and water disposal, and recycling and discharge services;
- the ability to renew leases for general purpose and high pressure railcars;
- the ability to renew leases for underground natural gas liquids storage;
- the nonpayment or nonperformance by our customers;
- the availability and cost of capital and our ability to access certain capital sources;
- a deterioration of the credit and capital markets;
- the ability to successfully identify and consummate strategic acquisitions on economically favorable terms that are accretive to our financial results;

- the ability to successfully integrate acquired assets and businesses;
- changes in the volume of crude oil recovered during the wastewater treatment process;
- changes in the financial condition and results of operations of entities in which we own noncontrolling equity interests;
- changes in laws and regulations to which we are subject, including tax, environmental, transportation, and employment regulations, or new interpretations by regulatory agencies concerning such laws and regulations and the impact of such laws and regulations (now existing or in the future) on our business operations, including our sales of crude oil, condensate, natural gas liquids, refined products, ethanol, and biodiesel; our processing of wastewater; and transportation and risk management activities;
- the costs and effects of legal and administrative proceedings;
- any reduction or the elimination of the Renewable Fuels Standard;
- the operational and financial success of our joint ventures; and
- changes in the jurisdictional characteristics of, or the applicable regulatory policies with respect to, our pipeline assets.

You should not put undue reliance on any forward-looking statements. All forward-looking statements speak only as of the date of this Quarterly Report. Except as required by state and federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statements as a result of new information, future events, or otherwise. When considering forward-looking statements, please review the risks described under Item 1A Risk Factors in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014, and as supplemented and updated by Part II, Item 1A Risk Factors in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014.

Table of Contents

PART I

Item 1. Financial Statements (Unaudited)

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Unaudited Condensed Consolidated Balance Sheets

(U.S. Dollars in Thousands, except unit amounts)

	December 31, 2014	March 31, 2014
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 30,556	$ 10,440
Accounts receivable - trade, net of allowance for doubtful accounts of $3,293 and $2,822, respectively	1,664,039	900,904
Accounts receivable - affiliates	42,549	7,445
Inventories	535,928	310,160
Prepaid expenses and other current assets	184,675	80,350
Total current assets	2,457,747	1,309,299
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of $181,198 and $109,564, respectively	1,472,295	829,346
GOODWILL	1,250,239	1,107,006
INTANGIBLE ASSETS, net of accumulated amortization of $191,364 and $116,728, respectively	1,153,028	714,956
INVESTMENTS IN UNCONSOLIDATED ENTITIES	478,444	189,821
OTHER NONCURRENT ASSETS	94,149	16,795
Total assets	$ 6,905,902	$ 4,167,223
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable - trade	$ 1,534,568	$ 740,211
Accounts payable - affiliates	12,766	76,846
Accrued expenses and other payables	277,304	141,690
Advance payments received from customers	72,075	29,965
Current maturities of long-term debt	4,455	7,080
Total current liabilities	1,901,168	995,792
LONG-TERM DEBT, net of current maturities	2,753,322	1,629,834
OTHER NONCURRENT LIABILITIES	11,811	9,744
COMMITMENTS AND CONTINGENCIES		
EQUITY, per accompanying statement:		
General partner, representing a 0.1% interest, 88,634 and 79,420 notional units at December 31, 2014 and March 31, 2014, respectively	(39,035)	(45,287)

Limited partners, representing a 99.9% interest -				
Common units, 88,545,764 and 73,421,309 units issued and outstanding at December 31, 2014 and March 31, 2014, respectively		1,709,150		1,570,074
Subordinated units, 5,919,346 units issued and outstanding at March 31, 2014				2,028
Accumulated other comprehensive loss		(89)		(236)
Noncontrolling interests		569,575		5,274
Total equity		2,239,601		1,531,853
Total liabilities and equity	$	6,905,902	$	4,167,223

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

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Operations

(U.S. Dollars in Thousands, except unit and per unit amounts)

	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
REVENUES:				
Crude oil logistics	$ 1,694,881	$ 1,316,060	$ 5,735,307	$ 3,260,862
Water solutions	50,241	41,772	150,274	96,475
Liquids	685,096	800,917	1,700,006	1,646,750
Retail propane	139,765	161,537	286,025	293,134
Refined products and renewables	1,983,444	306,600	5,708,161	306,600
Other	(1,281)	116,559	1,513	119,518
Total Revenues	4,552,146	2,743,445	13,581,286	5,723,339
COST OF SALES:				
Crude oil logistics	1,697,374	1,300,911	5,678,725	3,202,265
Water solutions	(29,085)	2,571	(27,951)	6,936
Liquids	657,010	745,894	1,633,090	1,555,539
Retail propane	81,172	105,394	168,590	181,956
Refined products and renewables	1,905,021	306,350	5,570,185	306,350
Other	176	114,909	2,547	114,909
Total Cost of Sales	4,311,668	2,576,029	13,025,186	5,367,955
OPERATING COSTS AND EXPENSES:				
Operating	97,761	68,921	262,616	171,572
Loss on disposal of assets, net	30,073	340	34,639	2,503
General and administrative	44,230	21,492	113,742	54,258
Depreciation and amortization	50,335	35,494	139,809	83,279
Operating Income	18,079	41,169	5,294	43,772
OTHER INCOME (EXPENSE):				
Earnings of unconsolidated entities	1,242		7,504	
Interest expense	(30,051)	(16,745)	(79,196)	(38,427)
Other income, net	3,371	154	2,363	623
Income (Loss) Before Income Taxes	(7,359)	24,578	(64,035)	5,968
INCOME TAX (PROVISION) BENEFIT	2,090	(526)	2,977	(356)
Net Income (Loss)	(5,269)	24,052	(61,058)	5,612
LESS: NET INCOME ALLOCATED TO GENERAL PARTNER	(11,783)	(4,260)	(32,220)	(8,399)
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(5,649)	(154)	(9,059)	(288)
NET INCOME (LOSS) ALLOCATED TO LIMITED PARTNERS	$ (22,701)	$ 19,638	$ (102,337)	$ (3,075)
	$ (0.26)	$ 0.27	$ (1.17)	$ (0.03)

BASIC AND DILUTED INCOME (LOSS) PER COMMON UNIT				
BASIC AND DILUTED WEIGHTED AVERAGE COMMON UNITS OUTSTANDING	88,545,764	67,941,726	83,702,571	58,222,924

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

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(U.S. Dollars in Thousands)

	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
Net income (loss)	$ (5,269)	$ 24,052	$ (61,058)	$ 5,612
Other comprehensive income (loss)	(16)	(100)	147	(130)
Comprehensive income (loss)	$ (5,285)	$ 23,952	$ (60,911)	$ 5,482

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

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Unaudited Condensed Consolidated Statement of Changes in Equity

Nine Months Ended December 31, 2014

(U.S. Dollars in Thousands, except unit amounts)

		Limited Partners						
	General Partner	Common Units	Amount	Subordinated Units	Amount	Accumulated Other Comprehensive Loss	Noncontrolling Interests	Total Equity
BALANCES AT MARCH 31, 2014	$ (45,287)	73,421,309	$ 1,570,074	5,919,346	$ 2,028	$ (236)	$ 5,274	$ 1,531,853
Distributions	(26,376)		(142,927)		(6,748)		(17,497)	(193,548)
Contributions	408							408
Sales of units, net of issuance costs		8,767,100	370,376					370,376
Equity issued pursuant to incentive compensation plan		438,009	18,684					18,684
Business combinations							572,895	572,895
Net income (loss)	32,220		(98,324)		(4,013)		9,059	(61,058)
Other comprehensive income						147		147
Conversion of subordinated units to common units		5,919,346	(8,733)	(5,919,346)	8,733			
Other							(156)	(156)
BALANCES AT DECEMBER 31, 2014	$ (39,035)	88,545,764	$ 1,709,150		$	$ (89)	$ 569,575	$ 2,239,601

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

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Unaudited Condensed Consolidated Statements of Cash Flows

(U.S. Dollars in Thousands)

	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
OPERATING ACTIVITIES:		
Net income (loss)	$ (61,058)	$ 5,612
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, including debt issuance cost amortization	152,228	89,851
Non-cash equity-based compensation expense	13,384	10,840
Loss on disposal of assets, net	34,639	2,503
Provision for doubtful accounts	2,398	2,112
Commodity derivative (gain) loss	(240,992)	26,711
Earnings of unconsolidated entities	(7,504)	
Distributions of earnings from unconsolidated entities	9,073	
Other	5,275	(318)
Changes in operating assets and liabilities, exclusive of acquisitions:		
Accounts receivable - trade	(574,658)	(160,169)
Accounts receivable - affiliates	(34,576)	19,072
Inventories	154,607	(165,116)
Prepaid expenses and other assets	(50,510)	(5,811)
Accounts payable - trade	679,945	203,934
Accounts payable - affiliates	(64,149)	8,592
Accrued expenses and other liabilities	24,314	(2,046)
Advance payments received from customers	39,424	29,006
Net cash provided by operating activities	81,840	64,773
INVESTING ACTIVITIES:		
Purchases of long-lived assets	(135,435)	(107,945)
Acquisitions of businesses, including acquired working capital, net of cash acquired	(1,114,045)	(1,240,175)
Cash flows from commodity derivatives	190,455	(30,659)
Proceeds from sales of assets	15,236	7,302
Investments in unconsolidated entities	(33,528)	(2,000)
Distributions of capital from unconsolidated entities	8,736	1,591
Other investments	(45,855)	
Other	(66)	(102)
Net cash used in investing activities	(1,114,502)	(1,371,988)
FINANCING ACTIVITIES:		
Proceeds from borrowings under revolving credit facilities	3,096,700	2,040,500
Payments on revolving credit facilities	(2,604,700)	(1,709,500)
Issuances of notes	400,000	450,000
Proceeds from borrowings on other long-term debt		880
Payments on other long-term debt	(5,476)	(6,713)
Debt issuance costs	(10,826)	(24,061)
Contributions	408	2,736
Distributions to partners	(176,051)	(98,657)
Distributions to noncontrolling interest owners	(17,497)	(840)
Proceeds from sale of common units, net of offering costs	370,376	650,210
Other	(156)	

Net cash provided by financing activities		1,052,778		1,304,555
Net increase (decrease) in cash and cash equivalents		20,116		(2,660)
Cash and cash equivalents, beginning of period		10,440		11,561
Cash and cash equivalents, end of period	$	30,556	$	8,901

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

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Note 1 Organization and Operations

NGL Energy Partners LP (we, us, our, or the Partnership) is a Delaware limited partnership. NGL Energy Holdings LLC serves as our general partner. At December 31, 2014, our operations include:

- Our crude oil logistics segment, the assets of which include owned and leased crude oil storage terminals, pipeline injection stations, a fleet of trucks, a fleet of leased and owned railcars, a fleet of barges and towboats, and a 50% interest in a crude oil pipeline. Our crude oil logistics segment purchases crude oil from producers and transports it for resale at owned and leased pipeline injection points, storage terminals, barge loading facilities, rail facilities, refineries, and other trade hubs.

- Our water solutions segment, the assets of which include water treatment and disposal facilities. Our water solutions segment generates revenues from the treatment and disposal of wastewater generated from crude oil and natural gas production, from the sale of recycled water and recovered hydrocarbons, and from the disposal of tank bottoms and drilling mud.

- Our liquids segment, which supplies natural gas liquids to retailers, wholesalers, refiners, and petrochemical plants throughout the United States and in Canada, and which provides natural gas liquids terminaling services through its more than 20 owned terminals throughout the United States and railcar transportation services through its fleet of leased and owned railcars. Our liquids segment purchases propane, butane, and other products from refiners, processing plants, producers, and other parties, and sells the products to retailers, refiners, petrochemical plants, and other participants in the wholesale markets.

- Our retail propane segment, which sells propane, distillates, and equipment and supplies to end users consisting of residential, agricultural, commercial, and industrial customers and to certain re-sellers in 25 states.

- Our refined products and renewables segment, which conducts gasoline, diesel, ethanol, and biodiesel marketing operations. We also own the 2.0% general partner interest and a 19.7% limited partner interest in TransMontaigne Partners L.P. (TLP), which conducts refined products terminaling operations. TLP also owns a 42.5% interest in Battleground Oil Specialty Terminal Company LLC (BOSTCO) and a 50% interest in Frontera Brownsville LLC (Frontera), which are entities that own refined products storage facilities.

Note 2 Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements as of and for the three months and nine months ended December 31, 2014 and 2013 include our accounts and those of our controlled subsidiaries. Investments where we do not have the ability to exercise control, but do have the ability to exercise significant influence, are accounted for using the equity method of accounting. All significant intercompany transactions and account balances have been eliminated in consolidation. The unaudited condensed consolidated balance sheet at March 31, 2014 is derived from audited financial statements. We have made certain reclassifications to prior period financial statements to conform to classification methods used in fiscal year 2015. These reclassifications had no impact on previously reported amounts of equity or net income.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim consolidated financial information in accordance with the rules and regulations of the Securities and Exchange Commission. The unaudited condensed consolidated financial statements include all adjustments that we consider necessary for a fair presentation of our consolidated financial position and results of operations for the interim periods presented. Such adjustments consist of only normal recurring items, unless otherwise disclosed herein. Accordingly, the unaudited condensed consolidated financial statements do not include all the information and notes required by GAAP for complete annual consolidated financial statements. However, we believe that the disclosures made are adequate to make the information presented not misleading. These interim unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the fiscal year ended March 31, 2014 included in our Annual Report on Form 10-K (Annual Report). Due to the seasonal nature of our liquids and retail propane operations and other factors, the results of operations for interim periods are not necessarily indicative of the results to be expected for a future periods or for the full fiscal year ending March 31, 2015.

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the period. Actual results could differ from those estimates.

Significant Accounting Policies

Our significant accounting policies are consistent with those disclosed in Note 2 of our audited consolidated financial statements included in our Annual Report.

Revenue Recognition

We record revenues from product sales at the time title to the product transfers to the purchaser, which typically occurs upon receipt of the product by the purchaser. We record terminaling, transportation, storage, and service revenues at the time the service is performed, and we record tank and other rentals over the term of the lease. Pursuant to terminaling services agreements with certain of our throughput customers, we are entitled to the volume of product gained resulting from differences in the measurement of product volumes received and distributed at our terminaling facilities. Such measurement differentials occur as the result of the inherent variances in measurement devices and methodology. We recognize as revenue the net proceeds from the sale of the product gained. Revenues for our water solutions segment are recognized upon receipt of the wastewater at our treatment and disposal facilities.

We report taxes collected from customers and remitted to taxing authorities, such as sales and use taxes, on a net basis. Amounts billed to customers for shipping and handling costs are included in revenues in our condensed consolidated statements of operations.

We enter into certain contracts whereby we agree to purchase product from a counterparty and sell the same volume of product to the same counterparty at a different location or time. When such agreements are entered into concurrently and are entered into in contemplation of each other, we record the revenues for these transactions net of cost of sales.

Fair Value Measurements

We apply fair value measurements to certain assets and liabilities, principally our commodity derivative instruments and assets and liabilities acquired in business combinations. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value is based upon assumptions that market participants would use when pricing an asset or liability, including assumptions about risk and risks inherent in valuation techniques and inputs to valuations. This includes not only the credit standing of counterparties and credit enhancements but also the impact of our own nonperformance risk on our liabilities. Fair value measurements assume that the transaction occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability (the market for which the reporting entity would be able to maximize the amount received or minimize the amount paid). We evaluate the need for credit adjustments to our derivative instrument fair values in accordance with the requirements noted above. Such adjustments were not material to the fair values of our derivative instruments.

We use the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets and liabilities that we have the ability to access at the measurement date.

- Level 2 Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Instruments categorized in Level 2 include non-exchange traded derivatives such as over-the-counter commodity price swap and option contracts and interest rate protection agreements. We determine the fair value of all our derivative financial instruments utilizing pricing models for significantly similar instruments. Inputs to the pricing model include publicly available prices and forward curves generated from a compilation of data gathered from third parties.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

- Level 3 Unobservable inputs for the asset or liability including situations where there is little, if any, market activity for the asset or liability.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall into different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement requires judgment, considering factors specific to the asset or liability.

Supplemental Cash Flow Information

Supplemental cash flow information is as follows:

	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
	(in thousands)			
Interest paid, exclusive of debt issuance costs and letter of credit fees	$ 28,927	$ 6,821	$ 65,356	$ 23,729
Income taxes paid	$ 303	$ 475	$ 2,549	$ 1,125
Value of common units issued in business combinations	$	$	$	$ 80,619

Cash flows from settlements of commodity derivative instruments are classified as cash flows from investing activities in the condensed consolidated statements of cash flows, and adjustments to the fair value of commodity derivative instruments are included in the reconciliation of net income (loss) to net cash provided by operating activities.

Inventories

We value our inventories at the lower of cost or market, with cost determined using either the weighted-average cost or the first in, first out (FIFO) methods, including the cost of transportation and storage. Market is determined based on estimated replacement cost using prices at the end of the period. In performing this analysis, we take into consideration fixed-price forward sale commitments and the opportunity to transfer propane inventory from our wholesale business to our retail business to sell the inventory in retail markets.

Inventories consist of the following:

	December 31, 2014	March 31, 2014
	(in thousands)	
Crude oil	$ 68,749	$ 156,473
Natural gas liquids		
Propane	184,583	85,159
Butane	25,468	15,106
Other	19,176	3,945
Refined products		
Gasoline	118,479	15,597
Diesel	68,584	7,612
Renewables	36,277	11,778
Other	14,612	14,490
Total	$ 535,928	$ 310,160

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Investments in Unconsolidated Entities

In December 2013, as part of our acquisition of Gavilon, LLC (Gavilon Energy), we acquired a 50% interest in Glass Mountain Pipeline, LLC (Glass Mountain) and an interest in a limited liability company that owns an ethanol production facility in the Midwest. In June 2014, we acquired an interest in a limited liability company that operates a water supply company in the DJ Basin. On July 1, 2014, as part of our acquisition of TransMontaigne Inc. (TransMontaigne), we acquired the general partner interest and a 19.7% limited partner interest in TLP, which owns a 42.5% interest in BOSTCO and a 50% interest in Frontera. We account for these investments using the equity method of accounting. Under the equity method, we do not report the individual assets and liabilities of these entities on our condensed consolidated balance sheets; instead, our ownership interests are reported within investments in unconsolidated entities on our condensed consolidated balance sheets. Under the equity method, the investment is recorded at acquisition cost, increased by our proportionate share of any earnings and additional capital contributions and decreased by our proportionate share of any losses, distributions paid, and amortization of any excess investment. Excess investment is the amount by which our total investment exceeds our proportionate share of the historical net book value of the net assets of the investee.

Our investments in unconsolidated entities consist of the following:

Entity	Segment	December 31, 2014	March 31, 2014
		(in thousands)	
Glass Mountain (1)	Crude oil logistics	$ 188,190	$ 181,488
BOSTCO (2)	Refined products and renewables	236,938	
Frontera	Refined products and renewables	23,755	
Water supply company	Water solutions	16,500	
Ethanol production facility	Refined products and renewables	13,061	8,333
Total		$ 478,444	$ 189,821

(1) When we acquired Gavilon Energy, we recorded the investment in Glass Mountain at fair value. The fair value of our investment in Glass Mountain exceeds our share of the historical net book value of Glass Mountain s net assets by approximately $70 million. This difference relates primarily to goodwill and customer relationships.

(2) When we acquired TransMontaigne, we recorded the investment in BOSTCO at fair value. The fair value of our investment in BOSTCO exceeds our share of the historical net book value of BOSTCO s net assets by approximately $11.8 million.

Other Noncurrent Assets

Other noncurrent assets consist of the following:

	December 31, 2014	March 31, 2014
	(in thousands)	
Capital lease (1)	$ 45,855	$
Linefill (2)	30,868	
Other	17,426	16,795
Total	$ 94,149	$ 16,795

(1) Represents a loan receivable associated with our financing of the construction of a natural gas liquids facility to be utilized by a third party.

(2) Represents minimum volumes of product we are required to leave in third-party owned pipelines under long-term shipment commitments. At December 31, 2014, linefill consisted of approximately 404,000 barrels of crude oil with an average cost basis of $76.41 per barrel.

Accrued Expenses and Other Payables

Accrued expenses and other payables consist of the following:

	December 31, 2014	March 31, 2014
	(in thousands)	
Accrued compensation and benefits	$ 55,950	$ 45,006
Derivative liabilities	62,591	42,214
Product exchange liabilities	24,448	3,719
Accrued interest	21,606	18,668
Income and other tax liabilities	64,123	13,421
Other	48,586	18,662
Total	$ 277,304	$ 141,690

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Business Combination Measurement Period

We record the assets acquired and liabilities assumed in a business combination at their acquisition date fair values. Pursuant to GAAP, an entity is allowed a reasonable period of time (not to exceed one year) to obtain the information necessary to identify and measure the fair value of the assets acquired and liabilities assumed in a business combination. As described in Note 4, certain of our acquisitions are still within this measurement period, and as a result, the acquisition date fair values we have recorded for the assets acquired and liabilities assumed are subject to change. Also as described in Note 4, we made certain adjustments during the nine months ended December 31, 2014 to our estimates of the acquisition date fair values of assets acquired and liabilities assumed in business combinations that occurred during the year ended March 31, 2014.

Noncontrolling Interests

We have certain consolidated subsidiaries in which outside parties own interests. The noncontrolling interest shown in our condensed consolidated financial statements represents the other owners share of these entities.

On July 1, 2014, as part of our acquisition of TransMontaigne, we acquired a 19.7% limited partner interest in TLP. We have attributed net earnings allocable to TLP s limited partners to the controlling and noncontrolling interests based on the relative ownership interests in TLP as well as including certain adjustments related to our acquisition accounting. Earnings allocable to TLP s limited partners are net of the earnings allocable to TLP s general partner interest. The earnings allocable to TLP s general partner interest include the distributions of available cash (as defined by TLP s partnership agreement) attributable to the period to TLP s general partner interest and incentive distribution rights, net of adjustments for TLP s general partner s share of undistributed earnings. Undistributed earnings are allocated to TLP s limited partners and TLP s general partner interest based on their respective sharing of earnings or losses specified in TLP s partnership agreement, which is based on their ownership percentages of 98% and 2%, respectively.

Note 3 Earnings Per Unit

Our earnings per common unit were computed as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
	(in thousands, except unit and per unit amounts)			
Net income (loss) attributable to parent equity	$ (10,918)	$ 23,898	$ (70,117)	$ 5,324
Less: Net income allocated to general partner (1)	(11,783)	(4,260)	(32,220)	(8,399)
Less: Net loss (income) allocated to subordinated unitholders (2)		(1,353)	4,013	1,295
Net income (loss) allocated to common unitholders	$ (22,701)	$ 18,285	$ (98,324)	$ (1,780)
Weighted average common units outstanding	88,545,764	67,941,726	83,702,571	58,222,924
Income (loss) per common unit - basic and diluted	$ (0.26)	$ 0.27	$ (1.17)	$ (0.03)

(1) The net income allocated to the general partner includes distributions to which it is entitled as the holder of incentive distribution rights, which are described in Note 10.

(2) All outstanding subordinated units converted to common units in August 2014. Since the subordinated units did not share in the distribution of cash generated during the three months ended September 30, 2014, we did not allocate any earnings or loss during this period to the subordinated unitholders. During the three months ended June 30, 2014 and the nine months ended December 31, 2013, 5,919,346 subordinated units were outstanding. The income (loss) per subordinated unit was ($0.68) for the three months ended June 30, 2014, $0.23 for the three months ended December 31, 2013, and $(0.22) for the nine months ended December 31, 2013.

The restricted units described in Note 10 were antidilutive during the three months and nine months ended December 31, 2014 and 2013, but could impact earnings per unit in future periods.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Note 4 Acquisitions

Year Ending March 31, 2015

Grand Mesa Pipeline, LLC

In September 2014, we entered into a joint venture with RimRock Midstream, LLC (RimRock) whereby each party owned a 50% interest in Grand Mesa Pipeline, LLC (Grand Mesa). Grand Mesa is constructing a crude oil pipeline originating in Weld County, Colorado and terminating at our Cushing, Oklahoma terminal. In October 2014, Grand Mesa completed a successful open season in which it received the requisite support, in the form of ship-or-pay volume commitments from multiple shippers, to begin construction of the pipeline system. In November 2014, we acquired RimRock s 50% ownership interest in Grand Mesa for $310.0 million in cash and preliminarily allocated this to a customer commitment intangible asset. We anticipate that the pipeline will commence service in late 2016, at which time we will begin to amortize this intangible asset.

Bakken Water Solutions Facilities

On November 21, 2014, we completed the acquisition of two saltwater disposal facilities in the Bakken Basin in North Dakota for $34.6 million of cash.

We are in the process of identifying and determining the fair value of the assets acquired and liabilities assumed in this business combination. The estimates of fair value reflected at December 31, 2014 are subject to change. We expect to complete this process prior to finalizing our financial statements for the quarter ending September 30, 2015. We have preliminarily estimated the fair values of the assets acquired (and useful lives) and liabilities assumed as follows (in thousands):

Property, plant and equipment:		
Water treatment facilities and equipment (5 40 years)	$	3,957
Buildings and leasehold improvements (3 7 years)		118
Other (7 years)		145

Goodwill		30,448
Other noncurrent liabilities		(68)
Fair value of net assets acquired	$	34,600

Goodwill represents the excess of the consideration paid for the acquired business over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill primarily represents the value of synergies between the acquired entity and the Partnership and the opportunity to use the acquired business as a platform for growth. We estimate that all of the goodwill will be deductible for federal income tax purposes.

The operations of these water disposal facilities have been included in our condensed consolidated statement of operations since their acquisition date. Our condensed consolidated statement of operations for the three months and nine months ended December 31, 2014 includes revenues of $1.0 million and operating income of $0.7 million that were generated by the operations of these water disposal facilities.

TransMontaigne Inc.

On July 1, 2014, we acquired TransMontaigne for $200.3 million of cash, net of cash acquired (including $174.1 million paid at closing and $26.2 million paid upon completion of the working capital settlement). As part of this transaction, we also purchased $380.4 million of inventory from the previous owner of TransMontaigne (including $346.9 million paid at closing and $33.5 million subsequently paid as the working capital settlement process progressed). The operations of TransMontaigne include the marketing of refined products. As part of this transaction, we acquired the 2.0% general partner interest, the incentive distribution rights, and a 19.7% limited partner interest in TLP, and assumed certain terminaling service agreements with TLP from an affiliate of the previous owner of TransMontaigne.

We are in the process of identifying and determining the fair value of the assets acquired and liabilities assumed in this business combination. The estimates of fair value reflected at December 31, 2014 are subject to change, and such changes could be material. We expect to complete this process prior to finalizing our financial statements for the three months ending June 30, 2015.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

We have preliminarily estimated the fair values of the assets acquired (and useful lives) and liabilities assumed as follows (in thousands):

Cash and cash equivalents	$	1,469
Accounts receivable - trade		197,554
Accounts receivable - affiliates		528
Inventories		379,512
Prepaid expenses and other current assets		15,082
Property, plant and equipment:		
Refined products terminal assets and equipment (20 years)		376,587
Vehicles		1,565
Crude oil tanks and related equipment (20 years)		28,666
Information technology equipment		7,851
Buildings and leasehold improvements (20 years)		10,339
Land		67,910
Tank bottoms		46,900
Other		12,592
Construction in progress		4,487
Goodwill (1)		38,576
Intangible assets:		
Customer relationships (15 years)		76,100
Pipeline capacity rights (30 years)		87,618
Trade names (indefinite life)		5,000
Investments in unconsolidated entities		245,400
Other noncurrent assets		3,911
Accounts payable - trade		(113,345)
Accounts payable - affiliates		(69)
Accrued expenses and other payables		(77,260)
Advance payments received from customers		(1,919)
Long-term debt		(234,000)
Other noncurrent liabilities		(33,227)
Noncontrolling interests		(567,120)
Fair value of net assets acquired	$	580,707

(1) Included in the refined products and renewables segment.

Goodwill represents the excess of the consideration paid for the acquired business over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill primarily represents the value of synergies between the acquired entity and the Partnership, the opportunity to use the acquired business as a platform for growth, and the acquired assembled workforce. We estimate that all of the goodwill will be deductible for federal income tax purposes.

The intangible asset for pipeline capacity rights relates to capacity allocations on a third-party refined products pipeline. Demand for use of this pipeline exceeds the pipeline s capacity, and the limited capacity is allocated based on a shipper s historical shipment volumes.

The fair value of the noncontrolling interests was calculated by multiplying the closing price of TLP s common units on the acquisition date by the number of TLP common units held by parties other than us.

We recorded in the acquisition accounting a liability of $2.5 million related to certain crude oil contracts with terms that were unfavorable at current market conditions. We amortized this balance to cost of sales during the three months ended September 30, 2014.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Employees of TransMontaigne participate in a plan whereby they are entitled to certain termination benefits in the event of a change in control of TransMontaigne and a subsequent change in job status. We recorded expense of $6.0 million and $8.7 million during the three months and nine months ended December 31, 2014, respectively, related to these termination benefits, and we may record additional expense in future quarters as we continue our integration efforts.

The operations of TransMontaigne have been included in our condensed consolidated statements of operations since TransMontaigne was acquired on July 1, 2014. Our condensed consolidated statement of operations for the nine months ended December 31, 2014 includes revenues of $3.0 billion and operating income of $16.7 million that were generated by the operations of TransMontaigne. We have not provided supplemental pro forma financial information as though the business combination had occurred on April 1, 2013. The previous owner of TransMontaigne conducted trading operations, whereas we strive to generate reliable and predictable cash flows. Because of the difference in strategies between the pre-acquisition and post-acquisition periods, the pre-acquisition operations of TransMontaigne have limited importance as an indicator of post-acquisition results.

Water Solutions Facilities

As described below, we are party to a development agreement that provides us a right to purchase water treatment and disposal facilities developed by the other party to the agreement. During the nine months ended December 31, 2014, we purchased 11 water treatment and disposal facilities under this development agreement. We also purchased a 75% interest in one additional water treatment and disposal facility in July 2014 from a different seller. On a combined basis, we paid $161.0 million of cash for these 12 facilities.

We are in the process of identifying and determining the fair value of the assets acquired and liabilities assumed in these business combinations. The estimates of fair value reflected at December 31, 2014 are subject to change, and such changes could be material. We expect to complete this process prior to finalizing our financial statements for the three months ending September 30, 2015. We have preliminarily estimated the fair values of the assets acquired (and useful lives) and liabilities assumed as follows (in thousands):

Accounts receivable - trade	$	939
Inventories		253
Prepaid expenses and other current assets		62
Property, plant and equipment:		
Water treatment facilities and equipment (5 40 years)		58,222
Buildings and leasehold improvements (3 7 years)		6,009
Land		2,120

Other (7 years)		213
Goodwill		105,434
Other noncurrent assets		50
Accounts payable - trade		(58)
Accrued expenses and other payables		(6,092)
Other noncurrent liabilities		(352)
Noncontrolling interest		(5,775)
Fair value of net assets acquired	$	161,025

Goodwill represents the excess of the consideration paid for the acquired business over the fair value of the individual assets acquired, net of liabilities assumed. Goodwill primarily represents the value of synergies between the acquired entity and the Partnership and the opportunity to use the acquired business as a platform for growth. We estimate that all of the goodwill will be deductible for federal income tax purposes.

The operations of these water treatment and disposal facilities have been included in our condensed consolidated statement of operations since their acquisition date. Our condensed consolidated statement of operations for the nine months ended December 31, 2014 includes revenues of $16.6 million and operating income of $5.7 million that were generated by the operations of these facilities.

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Retail Propane Acquisitions

During the nine months ended December 31, 2014, we completed seven acquisitions of retail propane businesses. On a combined basis, we paid $12.4 million of cash to acquire these assets and operations. The agreements for these acquisitions contemplate post-closing payments for certain working capital items. We are in the process of identifying and determining the fair value of the assets acquired and liabilities assumed in certain of these business combinations, and as a result, the estimates of fair value reflected at December 31, 2014 are subject to change.

Water Supply Company

On June 9, 2014, we paid cash of $15.0 million in exchange for an interest in a water supply company operating in the DJ Basin. The company holds exclusive rights to construct water disposal facilities on a dedicated acreage. We account for this investment using the equity method of accounting.

Year Ended March 31, 2014

Gavilon Energy

On December 2, 2013, we completed a business combination in which we acquired Gavilon Energy. We paid $832.4 million of cash, net of cash acquired, in exchange for these assets and operations.

The assets of Gavilon Energy include crude oil terminals in Oklahoma, Texas, and Louisiana, a 50% interest in Glass Mountain, which owns a crude oil pipeline that originates in western Oklahoma and terminates in Cushing, Oklahoma, and an interest in an ethanol production facility in the Midwest. The operations of Gavilon Energy include the marketing of crude oil, refined products, ethanol, biodiesel, and natural gas liquids, and also include crude oil storage in Cushing, Oklahoma.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

During the three months ended September 30, 2014, we completed the acquisition accounting for this business combination. The following table presents the final calculation of the fair values of the assets acquired (and useful lives) and liabilities assumed for this acquisition:

	Final	Estimated at March 31, 2014 (in thousands)	Change
Accounts receivable - trade	$ 326,484	$ 349,529	$ (23,045)
Accounts receivable - affiliates	2,564	2,564	
Inventories	107,430	107,430	
Prepaid expenses and other current assets	68,322	68,322	
Property, plant and equipment:			
Vehicles (3 years)	327	791	(464)
Crude oil tanks and related equipment (3 40 years)	83,797	77,429	6,368
Information technology equipment (3 7 years)	4,049	4,046	3
Buildings and leasehold improvements (3 40 years)	7,817	7,716	101
Land	6,427	6,427	
Tank bottoms	16,930	15,230	1,700
Other (7 years)	162	170	(8)
Construction in progress	7,180	7,190	(10)
Goodwill (1)	342,769	359,169	(16,400)
Intangible assets:			
Customer relationships (10 20 years)	107,950	101,600	6,350
Lease agreements (1 5 years)	8,700	8,700	
Pipeline capacity rights (30 years)	7,800		7,800
Investments in unconsolidated entities	183,000	178,000	5,000
Other noncurrent assets	2,287	9,918	(7,631)
Accounts payable - trade	(342,792)	(342,792)	
Accounts payable - affiliates	(2,585)	(2,585)	
Accrued expenses and other payables	(49,447)	(70,999)	21,552
Advance payments received from customers	(10,667)	(10,667)	
Other noncurrent liabilities	(46,056)	(44,740)	(1,316)
Fair value of net assets acquired	$ 832,448	$ 832,448	$

(1) Of this goodwill, $302.8 million was allocated to our crude oil logistics segment, $36.0 million was allocated to our refined products and renewables segment, and $4.0 million was allocated to our liquids segment.

We estimated the value of the customer relationship intangible asset using the income approach, which uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

The acquisition method of accounting requires that executory contracts that are at unfavorable terms relative to current market conditions at the acquisition date be recorded as assets or liabilities in the acquisition accounting. Since certain crude oil storage lease commitments were at unfavorable terms relative to acquisition date market conditions, we recorded a liability of $15.9 million related to these lease commitments in the acquisition accounting, and we amortized $6.9 million of this balance through cost of sales during the nine months ended December 31, 2014. We will amortize the remainder of this liability over the term of the leases. The future amortization of this liability is shown below (in thousands):

Year Ending March 31,		
2015 (three months)	$	1,740
2016		4,040
2017		360

Certain personnel who were employees of Gavilon Energy were entitled to a bonus, half of which was payable upon successful completion of the business combination and the remainder of which was paid in December 2014. We recorded this as compensation expense over the vesting period. We recorded expense of $6.5 million during the nine months ended December 31, 2014 related to these bonuses.

Oilfield Water Lines, LP

On August 2, 2013, we completed a business combination with entities affiliated with Oilfield Water Lines LP (collectively, OWL), whereby we acquired water disposal and transportation assets in Texas. We issued 2,463,287 common units, valued at $68.6 million, and paid $167.7 million of cash, net of cash acquired, in exchange for OWL. During the three months ended June 30, 2014, we completed the acquisition accounting for this business combination. The following table presents the final calculation of the fair values of the assets acquired (and useful lives) and liabilities assumed for this acquisition:

		Final		**Estimated at March 31, 2014**		**Change**
				(in thousands)		
Accounts receivable - trade	$	6,837	$	7,268	$	(431)
Inventories		154		154		
Prepaid expenses and other current assets		402		402		
Property, plant and equipment:						
Vehicles (5 10 years)		8,143		8,157		(14)
Water treatment facilities and equipment (3 30 years)		23,173		23,173		

Buildings and leasehold improvements (7 30 years)		2,198		2,198		
Land		710		710		
Other (3 5 years)		53		53		
Intangible assets:						
Customer relationships (8 10 years)		110,000		110,000		
Non-compete agreements (3 years)		2,000		2,000		
Goodwill		90,144		89,699		445
Accounts payable - trade		(6,469)		(6,469)		
Accrued expenses and other payables		(992)		(992)		
Other noncurrent liabilities		(64)		(64)		
Fair value of net assets acquired	$	236,289	$	236,289	$	

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

We estimated the value of the customer relationship intangible asset using the income approach, which uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts.

Other Water Solutions Acquisitions

During the year ended March 31, 2014, we completed two separate acquisitions of businesses to expand our water solutions operations in Texas. On a combined basis, we issued 222,381 common units, valued at $6.8 million, and paid $151.6 million of cash, net of cash acquired, in exchange for the assets and operations of these businesses. During the three months ended June 30, 2014, we completed the acquisition accounting for these business combinations. The following table presents the final calculation of the fair values of the assets acquired (and useful lives) and liabilities assumed for these acquisitions:

	Final	Estimated at March 31, 2014	Change
		(in thousands)	
Accounts receivable - trade	$ 2,146	$ 2,146	$
Inventories	192	192	
Prepaid expenses and other current assets	62	61	1
Property, plant and equipment:			
Vehicles (5 10 years)	76	90	(14)
Water treatment facilities and equipment (3 30 years)	11,717	14,394	(2,677)
Buildings and leasehold improvements (7 30 years)	3,278	1,906	1,372
Land	207	206	1
Other (3 5 years)	12	12	
Goodwill	49,067	47,750	1,317
Intangible assets:			
Customer relationships (8 10 years)	72,000	72,000	
Trade names (indefinite life)	3,325	3,325	
Non-compete agreements (3 years)	260	260	
Water facility development agreement (5 years)	14,000	14,000	
Water facility option agreement	2,500	2,500	
Accounts payable - trade	(119)	(119)	
Accrued expenses and other payables	(293)	(293)	
Other noncurrent liabilities	(64)	(64)	
Fair value of net assets acquired	$ 158,366	$ 158,366	$

As part of one of these business combinations, we entered into an option agreement with the seller of the business whereby we had the option to purchase a saltwater disposal facility that was under construction. We recorded an intangible asset of $2.5 million at the acquisition date related to this option agreement. On March 1, 2014, we purchased the saltwater disposal facility for additional cash consideration of $3.7 million.

In addition, as part of one of these business combinations, we entered into a development agreement that provides us a right to purchase water treatment and disposal facilities that may be developed by the seller through June 2018. On March 1, 2014, we purchased our first water treatment and disposal facility pursuant to the development agreement for $21.0 million.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

During the three months ended December 31, 2014, we completed the acquisition accounting for these business combinations. The following table presents the final calculation of the fair values of the assets acquired (and useful lives) and liabilities assumed for these acquisitions:

	Final	Estimated at March 31, 2014 (in thousands)	Change
Accounts receivable - trade	$ 124	$ 245	$ (121)
Inventories	119	197	(78)
Property, plant and equipment:			
Water treatment facilities and equipment (3 30 years)	10,539	10,540	(1)
Buildings and leasehold improvements (7 30 years)	1,130	1,130	
Land	213	213	
Other (3 5 years)	1	1	
Goodwill	15,443	15,281	162
Accounts payable - trade	(232)	(263)	31
Accrued expenses and other payables		(7)	7
Other noncurrent liabilities	(50)	(50)	
Fair value of net assets acquired	$ 27,287	$ 27,287	$

Crude Oil Logistics Acquisitions

During the year ended March 31, 2014, we completed two separate acquisitions of businesses to expand our crude oil logistics operations in Texas and Oklahoma. On a combined basis, we issued 175,211 common units, valued at $5.3 million, and paid $67.8 million of cash, net of cash acquired, in exchange for the assets and operations of these businesses. During the three months ended June 30, 2014, we completed the acquisition accounting for these business combinations. The following table presents the final calculation of the fair values of the assets acquired (and useful lives) and liabilities assumed for these acquisitions:

	Final	Estimated at March 31, 2014 (in thousands)	Change
Accounts receivable - trade	$ 1,221	$ 1,235	$ (14)
Inventories	1,021	1,021	
Prepaid expenses and other current assets	58	54	4

Property, plant and equipment:			
Vehicles (5 10 years)	2,980	2,977	3
Buildings and leasehold improvements (5 30 years)	58	280	(222)
Crude oil tanks and related equipment (2 30 years)	3,822	3,462	360
Barges and towboats (20 years)	20,065	20,065	
Other (3 5 years)	57	53	4
Goodwill	30,730	37,867	(7,137)
Intangible assets:			
Customer relationships (3 years)	13,300	6,300	7,000
Non-compete agreements (3 years)	35	35	
Trade names (indefinite life)	530	530	
Accounts payable - trade	(521)	(665)	144
Accrued expenses and other payables	(266)	(124)	(142)
Fair value of net assets acquired	$ 73,090	$ 73,090	$

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Retail Propane and Liquids Acquisitions

During the year ended March 31, 2014, we completed four acquisitions of retail propane businesses and the acquisition of four natural gas liquids terminals. On a combined basis, we paid $21.9 million of cash to acquire these assets and operations. During the three months ended December 31, 2014, we completed the acquisition accounting for these business combinations. The final calculation of the fair values of the assets acquired and liabilities assumed for these acquisitions did not materially change from the previous estimates of the fair values of the assets acquired and liabilities assumed for these acquisitions.

Note 5 Property, Plant and Equipment

Our property, plant and equipment consists of the following:

Description and Estimated Useful Lives	December 31, 2014	March 31, 2014
	(in thousands)	
Natural gas liquids terminal assets (2 30 years)	$ 75,850	$ 75,141
Refined products terminal assets and equipment (20 years)	379,118	
Retail propane equipment (2 30 years)	173,041	160,758
Vehicles and railcars (3 25 years)	177,056	152,676
Water treatment facilities and equipment (3 30 years)	264,918	180,985
Crude oil tanks and related equipment (2 40 years)	131,766	106,125
Barges and towboats (5 40 years)	58,579	52,217
Information technology equipment (3 7 years)	33,010	20,768
Buildings and leasehold improvements (3 40 years)	82,274	60,004
Land	101,789	30,241
Tank bottoms	64,594	13,403
Other (3 30 years)	34,669	6,341
Construction in progress	76,829	80,251
	1,653,493	938,910
Less: Accumulated depreciation	(181,198)	(109,564)
Net property, plant and equipment	$ 1,472,295	$ 829,346

Depreciation expense was $29.7 million and $15.6 million during the three months ended December 31, 2014 and 2013, respectively, and $76.6 million and $42.8 million during the nine months ended December 31, 2014 and 2013, respectively.

Product volumes required for the operation of storage tanks, known as tank bottoms, are recorded at historical cost. We recover tank bottoms when we no longer use the storage tanks or the storage tanks are removed from service. At December 31, 2014, tank bottoms consisted of approximately 185,000 barrels of crude oil with an average cost basis of $91.42 per barrel and approximately 16.8 million gallons of refined products with an average cost basis of $2.78 per gallon.

Note 6 Goodwill and Intangible Assets

The changes in the balance of goodwill during the nine months ended December 31, 2014 were as follows (in thousands):

Balance at March 31, 2014	$	1,107,006
Revisions to acquisition accounting (Note 4)		(21,614)
Acquisitions (Note 4)		174,829
Disposals		(9,982)
Balance at December 31, 2014	$	1,250,239

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

During the nine months ended December 31, 2014, we sold a natural gas liquids terminal and a water transportation business. We allocated goodwill of $8.2 million and $1.8 million, respectively, to these transactions and recorded corresponding losses on disposal of these assets to our condensed consolidated statements of operations. We also recorded losses on property, plant and equipment of $21.7 million and $2.2 million, respectively, related to these disposals.

Goodwill by reportable segment is as follows:

	December 31, 2014	March 31, 2014
	(in thousands)	
Crude oil logistics	$ 579,844	$ 606,383
Water solutions	398,280	262,203
Liquids	82,950	90,135
Retail propane	114,588	114,285
Refined products and renewables	74,577	34,000
Total	$ 1,250,239	$ 1,107,006

Our intangible assets consist of the following:

		December 31, 2014		March 31, 2014	
	Amortizable Lives	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
			(in thousands)		
Amortizable					
Customer relationships	3 20 years	$ 789,418	$ 136,824	$ 697,405	$ 83,261
Pipeline capacity rights	30 years	95,418	1,742		
Water facility development agreement	5 years	14,000	4,200	14,000	2,100
Executory contracts and other agreements	2 10 years	23,920	17,387	23,920	13,190
Non-compete agreements	2 7 years	14,562	9,271	14,161	6,388
Trade names	2 10 years	14,539	6,752	15,489	3,081
Debt issuance costs	5 10 years	54,915	15,188	44,089	8,708
Total amortizable		1,006,772	191,364	809,064	116,728
Non-amortizable					
Customer commitments		310,000			
Trade names		27,620		22,620	

Total	$	1,344,392	$	191,364	$	831,684	$	116,728

The weighted-average remaining amortization period for intangible assets is approximately 12 years.

Amortization expense is as follows:

Recorded In	Three Months Ended December 31,				Nine Months Ended December 31,			
	2014		2013		2014		2013	
				(in thousands)				
Depreciation and amortization	$	20,612	$	19,888	$	63,216	$	40,488
Cost of sales		1,818		943		5,939		2,517
Interest expense		2,451		1,593		6,480		4,055
Total	$	24,881	$	22,424	$	75,635	$	47,060

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Expected amortization of our intangible assets, exclusive of assets that are not yet amortizable, is as follows (in thousands):

Year Ending March 31,		
2015 (three months)	$	24,626
2016		95,854
2017		89,131
2018		85,154
2019		77,831
Thereafter		442,812
Total	$	815,408

Note 7 Long-Term Debt

Our long-term debt consists of the following:

		December 31, 2014		**March 31, 2014**
		(in thousands)		
Revolving credit facility				
Expansion capital borrowings	$	598,000	$	532,500
Working capital borrowings		798,000		389,500
5.125% Notes due 2019		400,000		
6.875% Notes due 2021		450,000		450,000
6.650% Notes due 2022		250,000		250,000
TLP credit facility		252,000		
Other long-term debt		9,777		14,914
		2,757,777		1,636,914
Less: Current maturities		4,455		7,080
Long-term debt	$	2,753,322	$	1,629,834

Credit Agreement

We have entered into a credit agreement (as amended, the Credit Agreement) with a syndicate of banks. The Credit Agreement includes a revolving credit facility to fund working capital needs (the Working Capital Facility) and a revolving credit facility to fund acquisitions and expansion projects (the Expansion Capital Facility, and together with the Working Capital Facility, the Revolving Credit Facility). At December 31, 2014, our Revolving Credit Facility had a total capacity of $2.296 billion.

The Expansion Capital Facility had a total capacity of $858.0 million for cash borrowings at December 31, 2014. At that date, we had outstanding borrowings of $598.0 million on the Expansion Capital Facility. The Working Capital Facility had a total capacity of $1.438 billion for cash borrowings and letters of credit at December 31, 2014. At that date, we had outstanding borrowings of $798.0 million and outstanding letters of credit of $176.1 million on the Working Capital Facility. The capacity available under the Working Capital Facility may be limited by a borrowing base, as defined in the Credit Agreement, which is calculated based on the value of certain working capital items at any point in time.

The commitments under the Credit Agreement expire on November 5, 2018. We have the right to prepay outstanding borrowings under the Credit Agreement without incurring any penalties, and prepayments of principal may be required if we enter into certain transactions to sell assets or obtain new borrowings.

All borrowings under the Credit Agreement bear interest, at our option, at (i) an alternate base rate plus a margin of 0.50% to 1.50% per annum or (ii) an adjusted LIBOR rate plus a margin of 1.50% to 2.50% per annum. The applicable margin is determined based on our consolidated leverage ratio, as defined in the Credit Agreement. At December 31, 2014, all borrowings under the Credit Agreement were LIBOR borrowings with an interest rate at December 31, 2014 of 2.17%, calculated as the LIBOR rate of 0.17% plus

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

a margin of 2.0%. At December 31, 2014, the interest rate in effect on letters of credit was 2.0%. Commitment fees are charged at a rate ranging from 0.38% to 0.50% on any unused credit.

The Credit Agreement is secured by substantially all of our assets. The Credit Agreement specifies that our leverage ratio, as defined in the Credit Agreement, cannot exceed 4.25 to 1 at any quarter end. At December 31, 2014, our leverage ratio was approximately 3.3 to 1. The Credit Agreement also specifies that our interest coverage ratio, as defined in the Credit Agreement, cannot be less than 2.75 to 1 at any quarter end. At December 31, 2014, our interest coverage ratio was approximately 5.6 to 1.

The Credit Agreement contains various customary representations, warranties, and additional covenants, including, without limitation, limitations on fundamental changes and limitations on indebtedness and liens. Our obligations under the Credit Agreement may be accelerated following certain events of default (subject to applicable cure periods), including, without limitation, (i) the failure to pay principal or interest when due, (ii) a breach by the Partnership or its subsidiaries of any material representation or warranty or any covenant made in the Credit Agreement, or (iii) certain events of bankruptcy or insolvency.

At December 31, 2014, we were in compliance with the covenants under the Credit Agreement.

2019 Notes

On July 9, 2014, we issued $400.0 million of 5.125% Senior Notes Due 2019 (the 2019 Notes) in a private placement exempt from registration under the Securities Act of 1933, as amended (the Securities Act), pursuant to Rule 144A and Regulation S under the Securities Act. We received net proceeds of $393.5 million, after the initial purchasers discount of $6.0 million and offering costs of $0.5 million. We used the net proceeds to reduce the outstanding balance on our Revolving Credit Facility.

The 2019 Notes mature on July 15, 2019. Interest is payable on January 15 and July 15 of each year. We have the right to redeem the 2019 Notes prior to the maturity date, although we would be required to pay a premium for early redemption.

The Partnership and NGL Energy Finance Corp. are co-issuers of the 2019 Notes, and the obligations under the 2019 Notes are guaranteed by certain of our existing and future restricted subsidiaries that incur or guarantee indebtedness under certain of our other indebtedness, including the Revolving Credit Facility. The purchase agreement and the indenture governing the 2019 Notes contain various customary representations, warranties, and additional covenants, including, without limitation, limitations on fundamental changes and limitations on indebtedness and liens. Our obligations under the purchase agreement and the indenture may be accelerated following certain events of default (subject to applicable cure periods), including, without limitation, (i) the failure to pay principal or interest when due, (ii) experiencing an event of default on certain other debt agreements, or (iii) certain events of bankruptcy or insolvency.

At December 31, 2014, we were in compliance with the covenants under the purchase agreement and indenture governing the 2019 Notes.

We also entered into a registration rights agreement whereby we have committed to exchange the 2019 Notes for a new issue of notes registered under the Securities Act that has substantially identical terms to the 2019 Notes. We expect to complete this exchange in February 2015.

2021 Notes

On October 16, 2013, we issued $450.0 million of 6.875% Senior Notes Due 2021 (the 2021 Notes) in a private placement exempt from registration under the Securities Act pursuant to Rule 144A and Regulation S under the Securities Act. We received net proceeds of $438.4 million, after the initial purchasers discount of $10.1 million and offering costs of $1.5 million. We used the net proceeds to reduce the outstanding balance on our Revolving Credit Facility.

The 2021 Notes mature on October 15, 2021. Interest is payable on April 15 and October 15 of each year. We have the right to redeem the 2021 Notes prior to the maturity date, although we would be required to pay a premium for early redemption.

The Partnership and NGL Energy Finance Corp. are co-issuers of the 2021 Notes, and the obligations under the 2021 Notes are guaranteed by certain of our existing and future restricted subsidiaries that incur or guarantee indebtedness under certain of our other indebtedness, including the Revolving Credit Facility. The purchase agreement and the indenture governing the 2021 Notes contain various customary representations, warranties, and additional covenants, including, without limitation, limitations on fundamental changes and limitations on indebtedness and liens. Our obligations under the purchase agreement and the indenture may

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

be accelerated following certain events of default (subject to applicable cure periods), including, without limitation, (i) the failure to pay principal or interest when due, (ii) experiencing an event of default on certain other debt agreements, or (iii) certain events of bankruptcy or insolvency.

At December 31, 2014, we were in compliance with the covenants under the purchase agreement and indenture governing the 2021 Notes.

We also entered into a registration rights agreement whereby we have committed to exchange the 2021 Notes for a new issue of notes registered under the Securities Act that has substantially identical terms to the 2021 Notes. We expect to complete this exchange in February 2015.

2022 Notes

On June 19, 2012, we entered into a Note Purchase Agreement (as amended, the Note Purchase Agreement) whereby we issued $250.0 million of Senior Notes in a private placement (the 2022 Notes). The 2022 Notes bear interest at a fixed rate of 6.65%. Interest is payable quarterly. The 2022 Notes are required to be repaid in semi-annual installments of $25.0 million beginning on December 19, 2017 and ending on the maturity date of June 19, 2022. We have the option to prepay outstanding principal, although we would incur a prepayment penalty. The 2022 Notes are secured by substantially all of our assets and rank equal in priority with borrowings under the Credit Agreement.

The Note Purchase Agreement contains various customary representations, warranties, and additional covenants that, among other things, limit our ability to (subject to certain exceptions): (i) incur additional debt, (ii) pay dividends and make other restricted payments, (iii) create or permit certain liens, (iv) create or permit restrictions on the ability of certain of our subsidiaries to pay dividends or make other distributions to us, (v) enter into transactions with affiliates, (vi) enter into sale and leaseback transactions and (vii) consolidate or merge or sell all or substantially all or any portion of our assets. In addition, the Note Purchase Agreement contains similar leverage ratio and interest coverage ratio requirements to those of our Credit Agreement, which is described above.

The Note Purchase Agreement provides for customary events of default that include, among other things (subject in certain cases to customary grace and cure periods): (i) nonpayment of principal or interest, (ii) breach of certain covenants contained in the Note Purchase Agreement or the 2022 Notes, (iii) failure to pay certain other indebtedness or the acceleration of certain other indebtedness prior to maturity if the total amount of such indebtedness unpaid or accelerated exceeds $10.0 million, (iv) the rendering of a judgment for the payment of money in excess of $10.0 million, (v) the failure of the Note Purchase Agreement, the 2022 Notes, or the guarantees by the subsidiary guarantors to be in full force and effect in all material respects and (vi) certain events of bankruptcy or insolvency. Generally, if an event of default occurs (subject to certain exceptions), the trustee or the holders of at least 51% in aggregate principal amount of the then outstanding 2022 Notes of any series may declare all of the 2022 Notes of such series to be due and payable immediately.

At December 31, 2014, we were in compliance with the covenants under the Note Purchase Agreement.

TLP Credit Facility

On March 9, 2011, TLP entered into an amended and restated senior secured credit facility (TLP Credit Facility), which has been subsequently amended from time to time. The TLP Credit Facility provides for a maximum borrowing line of credit equal to the lesser of (i) $350 million or (ii) 4.75 times Consolidated EBITDA (as defined in the TLP Credit Facility). TLP may elect to have loans under the TLP Credit Facility that bear interest either (i) at a rate of LIBOR plus a margin ranging from 2% to 3% depending on the total leverage ratio then in effect, or (ii) at the base rate plus a margin ranging from 1% to 2% depending on the total leverage ratio then in effect. TLP also pays a commitment fee on the unused amount of commitments, ranging from 0.375% to 0.50% per annum, depending on the total leverage ratio then in effect. TLP s obligations under the TLP Credit Facility are secured by a first priority security interest in favor of the lenders in the majority of TLP assets.

The terms of the TLP Credit Facility include covenants that restrict TLP s ability to make cash distributions, acquisitions and investments, including investments in joint ventures. TLP may make distributions of cash to the extent of its available cash as defined in the TLP partnership agreement.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

The following table summarizes our basis in the assets and liabilities of TLP at December 31, 2014, inclusive of the impact of our acquisition accounting for the business combination with TransMontaigne (in thousands):

Cash and cash equivalents	$	3,304
Accounts receivable - trade, net		10,310
Accounts receivable - affiliates		408
Inventories		1,591
Prepaid expenses and other current assets		1,474
Property, plant and equipment, net		475,950
Goodwill		38,576
Intangible assets, net		1,933
Investments in unconsolidated affiliates		260,694
Other noncurrent assets		1,670
Accounts payable - trade		(6,985)
Accounts payable - affiliates		(128)
Accrued expenses and other payables		(9,691)
Advanced payments received from customers		(144)
Long-term debt		(252,000)
Other noncurrent liabilities		(3,870)
Net assets	$	523,092

Under the TLP Credit Facility, TLP may make acquisitions and investments that meet the definition of permitted acquisitions ; other investments which may not exceed 5% of consolidated net tangible assets ; and permitted JV investments . Permitted JV investments include up to $225 million of investments in BOSTCO, the Specified BOSTCO Investment . In addition to the Specified BOSTCO Investment, under the terms of the TLP Credit Facility, TLP may make an additional $75 million of other permitted JV investments (including additional investments in BOSTCO). The principal balance of loans and any accrued and unpaid interest are due and payable in full on the maturity date, March 9, 2016.

The TLP Credit Facility also contains customary representations and warranties (including those relating to organization and authorization, compliance with laws, absence of defaults, material agreements and litigation) and customary events of default (including those relating to monetary defaults, covenant defaults, cross defaults and bankruptcy events). The primary financial covenants contained in the TLP Credit Facility are (i) a total leverage ratio (not to exceed 4.75 to 1), (ii) a senior secured leverage ratio (not to exceed 3.75 to 1) in the event TLP issues senior unsecured notes, and (iii) a minimum interest coverage ratio (not less than 3.0 to 1).

If TLP were to fail any financial covenant, or any other covenant contained in the TLP Credit Facility, TLP would seek a waiver from its lenders under such facility. If TLP was unable to obtain a waiver from its lenders and the default remained uncured after any applicable grace period, TLP would be in breach of the TLP Credit Facility, and the lenders would be entitled to declare all outstanding borrowings immediately due and payable. TLP was in compliance with all of the financial covenants under the TLP Credit Facility as of December 31, 2014.

At December 31, 2014, TLP had $252.0 million of outstanding borrowings under the TLP Credit Facility and no outstanding letters of credit.

Other Long-Term Debt

We have executed various noninterest bearing notes payable, primarily related to non-compete agreements entered into in connection with acquisitions of businesses. We also have certain notes payable related to equipment financing.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Debt Maturity Schedule

The scheduled maturities of our long-term debt are as follows at December 31, 2014:

Year Ending March 31,	Revolving Credit Facility	2019 Notes	2021 Notes	2022 Notes (in thousands)	TLP Credit Facility	Other Long-Term Debt	Total
2015 (three months)	$	$	$	$	$	$ 1,026	$ 1,026
2016					252,000	3,187	255,187
2017						2,398	2,398
2018				25,000		1,505	26,505
2019	1,396,000			50,000		1,480	1,447,480
Thereafter		400,000	450,000	175,000		181	1,025,181
Total	$ 1,396,000	$ 400,000	$ 450,000	$ 250,000	$ 252,000	$ 9,777	$ 2,757,777

Note 8 Income Taxes

We qualify as a partnership for income tax purposes. As such, we generally do not pay United States federal income tax. Rather, each owner reports his or her share of our income or loss on his or her individual tax return. The aggregate difference in the basis of our net assets for financial and tax reporting purposes cannot be readily determined, as we do not have access to information regarding each partner s basis in the Partnership.

We have certain taxable corporate subsidiaries in the United States and in Canada, and our operations in Texas are subject to a state franchise tax that is calculated based on revenues net of cost of sales. We utilize the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which these temporary differences are expected to be recovered or settled. Changes in tax rates are recognized in income in the period that includes the enactment date.

In December 2014 we converted TransMontaigne Inc. and certain of its subsidiaries from taxable corporations to non-taxable limited liability companies. Upon this conversion, the deferred tax liability associated with these entities became a current tax liability, and we reclassified $22.8

million from other noncurrent liabilities to accrued expenses and other payables on our consolidated balance sheet at December 31, 2014.

A publicly-traded partnership is required to generate at least 90% of its gross income (as defined for federal income tax purposes) from certain qualifying sources. Income generated by our taxable corporate subsidiaries is excluded from this qualifying income calculation. Although we routinely generate income outside of our corporate subsidiaries that is non-qualifying, we believe that at least 90% of our gross income has been qualifying income for each of the calendar years since our initial public offering.

We evaluate uncertain tax positions for recognition and measurement in the consolidated financial statements. To recognize a tax position, we determine whether it is more likely than not that the tax position will be sustained upon examination, including resolution of any related appeals or litigation, based on the technical merits of the position. A tax position that meets the more likely than not threshold is measured to determine the amount of benefit to be recognized in the consolidated financial statements. We had no material uncertain tax positions that required recognition in the consolidated financial statements at December 31, 2014.

Note 9 Commitments and Contingencies

Legal Contingencies

We are party to various claims, legal actions, and complaints arising in the ordinary course of business. In the opinion of our management, the ultimate resolution of these claims, legal actions, and complaints, after consideration of amounts accrued, insurance coverage, and other arrangements, will not have a material adverse effect on our consolidated financial position, results of operations or cash flows. However, the outcome of such matters is inherently uncertain, and estimates of our liabilities may change materially as circumstances develop.

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Customer Dispute

A customer of our crude oil logistics segment disputed the transportation rate schedule we used to bill the customer for services that we provided from November 2012 through February 2013, which was the same rate schedule that Pecos Gathering & Marketing, L.L.C. and certain of its affiliated companies (collectively, Pecos), used to bill the customer from April 2011 through October 2012 (prior to our November 1, 2012 acquisition of Pecos). During August 2013, the customer notified us that it intended to withhold payment due for services performed by us during the period from June 2013 through August 2013, pending resolution of the dispute, although the customer did not dispute the validity of the amounts billed for services performed during this time frame.

During September 2014, we reached an agreement with the former customer whereby the former customer agreed to pay us an agreed-upon amount to dismiss its claims against us, in return for which we agreed to dismiss our claims against the former customer. We did not record a gain or loss upon settlement, as the amount we received approximated the amount we had recorded as receivable from the customer.

Contractual Dispute

During the three months ended December 31, 2014, we settled a contractual dispute and recorded $2.5 million of proceeds to other income in our condensed consolidated statements of operations.

Environmental Matters

Our operations are subject to extensive federal, state, and local environmental laws and regulations. Although we believe our operations are in substantial compliance with applicable environmental laws and regulations, risks of additional costs and liabilities are inherent in our business, and there can be no assurance that significant costs will not be incurred. Moreover, it is possible that other developments, such as increasingly stringent environmental laws, regulations and enforcement policies thereunder, and claims for damages to property or persons resulting from the operations, could result in substantial costs. Accordingly, we have adopted policies, practices, and procedures in the areas of pollution control, product safety, occupational health, and the handling, storage, use, and disposal of hazardous materials designed to prevent material environmental or other damage, and to limit the financial liability that could result from such events. However, some risk of environmental or other damage is inherent in our business.

Asset Retirement Obligations

We have recorded a liability of $3.1 million at December 31, 2014 for asset retirement obligations. This liability is related to water treatment and disposal facilities and crude oil facilities for which we have contractual and regulatory obligations to perform remediation and, in some instances, dismantlement and removal activities when the assets are retired.

In addition to the obligations described above, we may be obligated to remove facilities or perform other remediation upon retirement of certain other assets. We do not believe the present value of these asset retirement obligations, under current laws and regulations, after taking into consideration the estimated lives of our facilities, is material to our consolidated financial position or results of operations.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Operating Leases

We have executed various noncancelable operating lease agreements for product storage, office space, vehicles, real estate, railcars, and equipment. Future minimum lease payments under these agreements at December 31, 2014 are as follows (in thousands):

Year Ending March 31,		
2015 (three months)	$	34,633
2016		111,286
2017		93,153
2018		78,683
2019		54,323
Thereafter		127,977
Total	$	500,055

Rental expense relating to operating leases was $36.8 million and $23.3 million during the three months ended December 31, 2014 and 2013, respectively, and $91.4 million and $68.8 million during the nine months ended December 31, 2014 and 2013, respectively.

Pipeline Capacity Agreements

We have executed noncancelable agreements with crude oil and refined products pipeline operators, which guarantee us minimum monthly shipping capacity on the pipelines. In exchange, we are obligated to pay the minimum shipping fees in the event actual shipments are less than our allotted capacity. Future minimum throughput payments under these agreements at December 31, 2014 are as follows (in thousands):

Year Ending March 31,		
2015 (three months)	$	23,199
2016		89,365
2017		53,750
2018		53,831
2019		53,037
Thereafter		109,272
Total	$	382,454

Construction Commitment

As discussed in Note 4, Grand Mesa completed a successful open season in which it received the requisite support, in the form of ship-or-pay volume commitments from multiple shippers, to begin construction of a 20-inch pipeline system. The estimated construction cost of Grand Mesa is $655.0 million and we anticipate that the pipeline will commence service in late 2016.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Sales and Purchase Contracts

We have entered into sales and purchase contracts for products to be delivered in future periods for which we expect the parties to physically settle the contracts with inventory. At December 31, 2014, we had the following such commitments outstanding:

	Volume	Value
	(in thousands)	
Purchase commitments:		
Natural gas liquids fixed-price (gallons)	60,493	$ 51,807
Natural gas liquids index-price (gallons)	312,125	176,492
Crude oil index-price (barrels)	4,796	221,205
Sale commitments:		
Natural gas liquids fixed-price (gallons)	221,370	236,371
Natural gas liquids index-price (gallons)	190,516	152,553
Crude oil index-price (barrels)	4,615	253,295

We account for the contracts shown in the table above as normal purchases and normal sales. Under this accounting policy election, we do not record the contracts at fair value at each balance sheet date; instead, we record the purchase or sale at the contracted value once the delivery occurs. Contracts in the table above may have offsetting derivative contracts (described in Note 11) or inventory positions (described in Note 2).

Certain other forward purchase and sale contracts do not qualify for the normal purchase and normal sale election. These contracts are recorded at fair value on our condensed consolidated balance sheet and are not included in the table above. These contracts are included in the derivative disclosures in Note 11, and represent $83.0 million of our prepaid expenses and other current assets and $47.2 million of our accrued expenses and other payables at December 31, 2014.

Note 10 Equity

Partnership Equity

The Partnership s equity consists of a 0.1% general partner interest and a 99.9% limited partner interest, which consists of common units. Prior to August 2014, the Partnership s limited partner interest also included subordinated units. The subordination period ended in August 2014, at which time all remaining subordinated units were converted into common units on a one-for-one basis.

Our general partner is not obligated to make any additional capital contributions or to guarantee or pay any of our debts and obligations.

Equity Issuance

On June 23, 2014, we completed a public offering of 8,000,000 common units. We received net proceeds of $338.0 million, after underwriting discounts and commissions of $12.3 million and offering costs of $0.5 million. During July 2014, the underwriters exercised their option to purchase an additional 767,100 units, from which we received net proceeds of $32.4 million.

Our Distribution Policy

Our general partner has adopted a cash distribution policy that requires us to pay a quarterly distribution to unitholders as of the record date to the extent we have sufficient cash from operations after establishment of cash reserves and payment of fees and expenses, including payments to the general partner and its affiliates, referred to as available cash. The general partner will also receive, in addition to distributions on its 0.1% general partner interest, additional distributions based on the level of distributions to the limited partners. These distributions are referred to as incentive distributionsOur general partner currently holds the incentive distribution rights, but may transfer these rights separately from its general partner interest, subject to restrictions in our partnership agreement.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

The following table illustrates the percentage allocations of available cash from operating surplus between the unitholders and our general partner based on the specified target distribution levels. The amounts set forth under Marginal Percentage Interest In Distributions are the percentage interests of our general partner and the unitholders in any available cash from operating surplus we distribute up to and including the corresponding amount in the column Total Quarterly Distribution Per Unit, until available cash from operating surplus we distribute reaches the next target distribution level, if any. The percentage interests shown for our unitholders and our general partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution. The percentage interests set forth below for our general partner include its 0.1% general partner interest, and assume that our general partner has contributed any additional capital necessary to maintain its 0.1% general partner interest and has not transferred its incentive distribution rights.

			Total Quarterly Distribution Per Unit				Marginal Percentage Interest In Distributions: Unitholders	General Partner
Minimum quarterly distribution					$	0.337500	99.9%	0.1%
First target distribution	above	$	0.337500	up to	$	0.388125	99.9%	0.1%
Second target distribution	above	$	0.388125	up to	$	0.421875	86.9%	13.1%
Third target distribution	above	$	0.421875	up to	$	0.506250	76.9%	23.1%
Thereafter	above	$	0.506250				51.9%	48.1%

During the three months ended December 31, 2014, we distributed a total of $65.0 million ($0.6088 per common and general partner notional unit) to our unitholders of record on November 4, 2014, which included an incentive distribution of $11.1 million to the general partner. In January 2015, we declared a distribution of $0.6175 per common unit, to be paid on February 13, 2015 to unitholders of record on February 6, 2015. This distribution is expected to be $66.5 million in total, including amounts to be paid on common and general partner notional units and the amount to be paid on incentive distribution rights.

TLP s Distribution Policy

TLP s partnership agreement requires it to pay a quarterly distribution to unitholders as of the record date to the extent TLP has sufficient cash from operations after establishment of cash reserves and payment of fees and expenses, including payments to TLP s general partner and its affiliates, referred to as available cash. TLP s general partner will also receive, in addition to distributions on its 2.0% general partner interest, additional distributions based on the level of distributions to the limited partners. These distributions are referred to as incentive distributions. TLP s general partner currently holds the incentive distribution rights, but may transfer these rights separately from its general partner interest, subject to restrictions in TLP s partnership agreement.

The following table illustrates the percentage allocations of available cash from operating surplus between TLP s unitholders and TLP s general partner based on the specified target distribution levels. The amounts set forth under Marginal Percentage Interest In Distributions are the percentage interests of TLP s general partner and TLP s unitholders in any available cash from operating surplus TLP distributes up to and including the corresponding amount in the column Total Quarterly Distribution Per Unit, until available cash from operating surplus TLP distributes reaches the next target distribution level, if any. The percentage interests shown for TLP s unitholders and TLP s general partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution. The percentage interests set forth below for TLP s general partner include its 2.0% general partner interest, and assume that TLP s general partner has contributed any additional capital necessary to maintain its 2.0% general partner interest and has not transferred its incentive distribution rights.

	Total Quarterly Distribution Per Unit					Marginal Percentage Interest In Distributions	
						Unitholders	**General Partner**
Minimum quarterly distribution					$ 0.40	98%	2%
First target distribution	above	$	0.40	up to	$ 0.44	98%	2%
Second target distribution	above	$	0.44	up to	$ 0.50	85%	15%
Third target distribution	above	$	0.50	up to	$ 0.60	75%	25%
Thereafter	above	$	0.60			50%	50%

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

During the three months ended December 31, 2014, TLP declared and paid a distribution of $0.665 per unit. We received a total of $4.0 million from this distribution on our general partner interest, incentive distribution rights, and limited partner interest. The noncontrolling interest owners received a total of $8.7 million from this distribution.

In January 2015, TLP declared a distribution of $0.665 per unit, which was paid on February 6, 2015. We received a total of $4.0 million from this distribution on our general partner interest, incentive distribution rights, and limited partner interest. The noncontrolling interest owners received a total of $8.6 million from this distribution.

Equity-Based Incentive Compensation

Our general partner has adopted a long-term incentive plan (LTIP), which allows for the issuance of equity-based compensation. Our general partner has granted certain restricted units to employees and directors, which vests in tranches, subject to the continued service of the recipients. The awards may also vest in the event of a change in control, at the discretion of the board of directors. No distributions accrue to or are paid on the restricted units during the vesting period.

The following table summarizes the restricted unit activity during the nine months ended December 31, 2014:

Unvested restricted units at March 31, 2014	1,311,100
Units granted	585,403
Units vested and issued	(438,009)
Units withheld for employee taxes	(231,194)
Units forfeited	(174,000)
Unvested restricted units at December 31, 2014	1,053,300

The scheduled vesting of our unvested restricted units is summarized below:

Vesting Date	Number of Awards
January 15, 2015	20,000
July 1, 2015	338,300

January 15, 2016	20,000
July 1, 2016	330,500
January 15, 2017	20,000
July 1, 2017	207,000
January 15, 2018	20,000
July 1, 2018	57,500
January 15, 2019	20,000
July 15, 2019	20,000
Unvested restricted units at December 31, 2014	1,053,300

We record the expense for the first tranche of each award on a straight-line basis over the period beginning with the grant date of the awards and ending with the vesting date of the tranche. We record the expense for succeeding tranches over the period beginning with the vesting date of the previous tranche and ending with the vesting date of the tranche.

At each balance sheet date, we adjust the cumulative expense recorded using the estimated fair value of the awards at the balance sheet date. We calculate the fair value of the awards using the closing price of our common units on the New York Stock Exchange on the balance sheet date, adjusted to reflect the fact that the holders of the unvested units are not entitled to distributions during the vesting period. We estimate the impact of the lack of distribution rights during the vesting period using the value of the most recent distribution and assumptions that a market participant might make about future distribution growth.

We recorded expense related to restricted unit awards of $1.6 million and $4.1 million during the three months ended December 31, 2014 and 2013, respectively, and $23.3 million and $14.4 million during the nine months ended December 31, 2014 and 2013, respectively. We estimate that the future expense we will record on the unvested awards at December 31, 2014 will be as

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

follows (in thousands), after taking into consideration an estimate of forfeitures of approximately 70,000 units. For purposes of this calculation, we used the closing price of our common units on December 31, 2014, which was $27.99.

Year Ending March 31,		
2015 (three months)	$	2,696
2016		9,499
2017		6,468
2018		2,786
Thereafter		1,301
Total	$	22,750

Following is a rollforward of the liability related to equity-based compensation, which is reported within accrued expenses and other payables on our condensed consolidated balance sheets (in thousands):

Balance at March 31, 2014	$	10,012
Expense recorded		23,285
Value of units vested and issued		(18,763)
Taxes paid on behalf of participants		(9,901)
Balance at December 31, 2014	$	4,633

The weighted-average fair value of the awards at December 31, 2014 was $23.75 per common unit, which was calculated as the closing price of the common units on December 31, 2014, adjusted to reflect the fact that the restricted units are not entitled to distributions during the vesting period. The impact of the lack of distribution rights during the vesting period was estimated using the value of the most recent distribution and assumptions that a market participant might make about future distribution growth.

The number of common units that may be delivered pursuant to awards under the LTIP is limited to 10% of the issued and outstanding common units. The maximum number of units deliverable under the plan automatically increases to 10% of the issued and outstanding common units immediately after each issuance of common units, unless the plan administrator determines to increase the maximum number of units deliverable by a lesser amount. Units withheld to satisfy tax withholding obligations are not considered to be delivered under the LTIP. In addition, when an award is forfeited, canceled, exercised, paid or otherwise terminates or expires without the delivery of units, the units subject to such award are again available for new awards under the LTIP. At December 31, 2014, approximately 6.9 million common units remain available for issuance under the LTIP.

Note 11 Fair Value of Financial Instruments

Our cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current assets and liabilities (excluding derivative instruments) are carried at amounts which reasonably approximate their fair values due to their short-term nature.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Commodity Derivatives

The following table summarizes the estimated fair values of our commodity derivative assets and liabilities reported on the condensed consolidated balance sheet at December 31, 2014:

	Derivative Assets	Derivative Liabilities
	(in thousands)	
Level 1 measurements	$ 99,633	$ (6,409)
Level 2 measurements	98,384	(58,594)
	198,017	(65,003)
Netting of counterparty contracts (1)	(2,352)	2,352
Cash collateral provided (held)	(74,047)	60
Commodity derivatives on condensed consolidated balance sheet	$ 121,618	$ (62,591)

(1) Relates to derivative assets and liabilities that are expected to be net settled on an exchange or through a master netting arrangement with the counterparty.

The following table summarizes the estimated fair values of our commodity derivative assets and liabilities reported on the condensed consolidated balance sheet at March 31, 2014:

	Derivative Assets	Derivative Liabilities
	(in thousands)	
Level 1 measurements	$ 4,990	$ (3,258)
Level 2 measurements	49,605	(43,303)
	54,595	(46,561)
Netting of counterparty contracts (1)	(4,347)	4,347
Net cash collateral provided	456	
Commodity derivatives on condensed consolidated balance sheet	$ 50,704	$ (42,214)

(1) Relates to derivative assets and liabilities that are expected to be net settled on an exchange or through a master netting arrangement with the counterparty.

Our commodity derivative assets and liabilities are reported in the following accounts on the condensed consolidated balance sheets:

	December 31, 2014	March 31, 2014
	(in thousands)	
Prepaid expenses and other current assets	$ 121,618	$ 50,704
Accrued expenses and other payables	(62,591)	(42,214)
Net commodity derivative asset	$ 59,027	$ 8,490

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

The following table summarizes our open commodity derivative contract positions at December 31, 2014 and March 31, 2014. We do not account for these derivatives as hedges.

Contracts	Settlement Period		Net Long (Short) Notional Positions In Barrels		Fair Value of Net Assets (Liabilities)
			(in thousands)		
At December 31, 2014 -					
Cross-commodity (1)	January 2015	February 2015	288	$	(3,955)
Crude oil fixed-price (2)	January 2015	March 2015	(1,034)		11,516
Crude oil index (3)	January 2015	March 2015	1,291		2,853
Propane fixed-price (4)	January 2015	March 2015	262		(3,827)
Refined products fixed-price (4)	January 2015	December 2015	(3,174)		114,092
Renewable products fixed-price (4)	January 2015	December 2015	(343)		5,235
Other	January 2015	January 2015	1,475		7,100
					133,014
Net cash collateral held					(73,987)
Net commodity derivatives on condensed consolidated balance sheet				$	59,027
At March 31, 2014 -					
Cross-commodity (1)	April 2014	March 2015	140	$	(1,876)
Crude oil fixed-price (2)	April 2014	March 2015	(1,600)		(2,796)
Crude oil index (3)	April 2014	December 2015	3,598		6,099
Propane fixed-price (4)	April 2014	March 2015	60		1,753
Refined products fixed-price (4)	April 2014	July 2014	732		560
Renewable products fixed-price (4)	April 2014	July 2014	106		4,084
Other	April 2014				210
					8,034
Net cash collateral provided					456
Net commodity derivatives on condensed consolidated balance sheet				$	8,490

(1) Cross-commodity Our operating segments may purchase or sell a physical commodity where the underlying contract pricing mechanisms are tied to different commodity price indices. The contracts listed in this table as Cross-commodity represent derivatives we have entered into as an economic hedge against the risk of one commodity price moving relative to another commodity price.

(2) Crude oil fixed-price Our crude oil logistics segment routinely purchases crude oil inventory to enable us to fulfill future orders expected to be placed by our customers. The contracts listed in this table as Crude oil fixed-price represent derivatives we have entered into as an economic hedge against the risk that crude oil prices will decline while we are holding the inventory.

(3) Crude oil index Our crude oil logistics segment may purchase or sell crude oil where the underlying contract pricing mechanisms are tied to different crude oil indices. These indices may vary in the type or location of crude oil, or in the timing of delivery within a given month. The contracts listed in this table as Crude oil index represent derivatives we have entered into as an economic hedge against the risk of one crude oil index moving relative to another crude oil index.

(4) Commodity fixed-price We may have fixed price physical obligations, including inventory, offset by floating price physical sales or have floating price physical purchases offset by fixed price physical sales. The contracts listed in the this table as fixed-price represent derivatives we have entered into as an economic hedge against the risk of mismatches between fixed and floating price physical obligations.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

We recorded the following net gains (losses) from our commodity derivatives to cost of sales:

Three Months Ended December 31,		Nine Months Ended December 31,	
2014	2013	2014	2013
(in thousands)			
$ 202,496	$ (8,830)	$ 240,992	$ (26,711)

Credit Risk

We maintain credit policies with regard to our counterparties on the derivative financial instruments that we believe minimize our overall credit risk, including an evaluation of potential counterparties financial condition (including credit ratings), collateral requirements under certain circumstances and the use of standardized agreements, which allow for netting of positive and negative exposure associated with a single counterparty.

We may enter into industry standard master netting agreements and may enter into cash collateral agreements requiring the counterparty to deposit funds into a brokerage margin account. The netting agreements reduce our credit risk by providing for net settlement of any offsetting positive and negative exposures with counterparties. The cash collateral agreements reduce the level of our net counterparty credit risk because the amount of collateral represents additional funds that we may access to net settle positions due us, and the amount of collateral adjusts each day in response to changes in the market value of counterparty derivatives.

Our counterparties consist primarily of financial institutions and energy companies. This concentration of counterparties may impact our overall exposure to credit risk, either positively or negatively, in that the counterparties may be similarly affected by changes in economic, regulatory or other conditions.

As is customary in the crude oil industry, we generally receive payment from customers for sales of crude oil on a monthly basis. As a result, receivables from individual customers in our crude oil logistics segment are generally higher than the receivables from customers in our other segments.

Failure of a counterparty to perform on a contract could result in our inability to realize amounts that have been recorded on our condensed consolidated balance sheets and recognized in our net income.

Interest Rate Risk

Our Revolving Credit Facility is variable-rate debt with interest rates that are generally indexed to bank prime or LIBOR interest rates. At December 31, 2014, we had $1.4 billion of outstanding borrowings under our Revolving Credit Facility at a rate of 2.17%. A change in interest rates of 0.125% would result in an increase or decrease of our annual interest expense of $1.7 million, based on borrowings outstanding at December 31, 2014.

The TLP Credit Facility is variable-rate debt with interest rates that are generally indexed to bank prime or LIBOR interest rates. At December 31, 2014, TLP had $252.0 million of outstanding borrowings under the TLP Credit Facility at a rate of 2.66%. A change in interest rates of 0.125% would result in an increase or decrease in TLP s annual interest expense of $0.3 million, based on borrowings outstanding at December 31, 2014.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

Fair Value of Notes

The following table provides estimates of the fair values of our fixed-rate notes at December 31, 2014 (in thousands):

5.125% Notes due 2019	$	388,000
6.875% Notes due 2021		438,000
6.650% Notes due 2022		253,000

For the 2019 Notes and the 2021 Notes, the fair value estimates were developed by reference to broker quotes. These estimates would be classified as Level 2 in the fair value hierarchy.

For the 2022 Notes, the estimate was developed using observed yields on publicly-traded notes issued by other entities, adjusted for differences in the key terms of those notes and the key terms of our notes (examples include differences in the tenor of the debt, credit standing of the issuer, whether the notes are publicly-traded, and whether the notes are secured or unsecured). This estimate of fair value would be classified as Level 3 in the fair value hierarchy.

Note 12 Segments

Certain financial data related to our segments is shown below. Transactions between segments are recorded based on prices negotiated between the segments.

Our liquids and retail propane segments each consist of two divisions, which are organized based on the location of the operations. Our refined products and renewables segment began with our December 2013 acquisition of Gavilon Energy and expanded with our July 2014 acquisition of TransMontaigne.

Items labeled corporate and other in the table below include the operations of a compressor leasing business that we sold in February 2014 and certain natural gas marketing operations that we acquired in our December 2013 acquisition of Gavilon Energy and wound down during fiscal year 2014. The corporate and other category also includes certain corporate expenses that are incurred and are not allocated to the reportable segments. This data is included to reconcile the data for the reportable segments to data in our condensed consolidated financial statements.

Table of Contents

NGL ENERGY PARTNERS LP AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements - Continued

At December 31, 2014 and March 31, 2014, and for the

Three Months and Nine Months Ended December 31, 2014 and 2013

	Three Months Ended December 31, 2014	Three Months Ended December 31, 2013	Nine Months Ended December 31, 2014	Nine Months Ended December 31, 2013
	(in thousands)			
Revenues:				
Crude oil logistics -				
Crude oil sales	$ 1,683,989	$ 1,319,290	$ 5,719,050	$ 3,260,885
Crude oil transportation and other	17,260	6,198	42,456	25,927
Water solutions -				
Service fees	30,870	15,589	72,809	42,864
Recovered hydrocarbons	19,355	20,693	66,704	40,929
Water transportation	16	5,490	10,761	12,682
Liquids -				
Propane sales	395,456	518,541	858,335	833,815
Other product sales	329,814	336,654	924,798	895,113
Other revenues	9,595	7,695	22,125	25,809
Retail propane -				
Propane sales	99,859	112,570	200,437	199,912
Distillate sales	29,102	37,648	59,327	66,079
Other revenues	10,804	11,377	26,261	27,275
Refined products and renewables -				
Refined products sales	1,833,090	252,154	5,285,824	252,154
Renewables sales	126,212	54,446	374,911	54,446
Service fees	24,746		48,030	
Corporate and other	(1,281)	116,559	1,513	119,518
Elimination of intersegment sales	(56,741)	(71,459)	(132,055)	(134,069)
Total revenues	$ 4,552,146	$ 2,743,445	$ 13,581,286	$ 5,723,339

Depreciation and Amortization:	By:	/s/ Rick Yan
	Name:	Rick Yan
	Title:	President and Chief Executive Officer

Date: March 30, 2018

Table of Contents

51JOB, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of 51job, Inc.:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of 51job, Inc. and its subsidiaries as of December 31, 2017 and December 31, 2016, and the related consolidated statements of operations and comprehensive income, of changes in shareholders equity and of cash flows for each of the three years in the period ended December 31, 2017, including the related notes (collectively referred to as the consolidated financial statements). We also have audited the Company s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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, 2017 and December 31, 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

Basis for Opinions

The Company s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Annual Report on Internal Control over Financial Reporting appearing in Item 15 of this Form 20-F. Our responsibility is to express opinions on the Company s consolidated financial statements and on the Company s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting 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 audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As described in Management s Annual Report on Internal Control over Financial Reporting appearing in Item 15 of this Form 20-F, management has excluded Lagou Information Limited from its assessment of internal control over financial reporting as of December 31, 2017 because it was acquired by the Company in a purchase business combination during 2017.

Definition and Limitations of Internal Control over Financial Reporting

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

Table of Contents

includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

/s/ PricewaterhouseCoopers Zhong Tian LLP

PricewaterhouseCoopers Zhong Tian LLP

Shanghai, the People s Republic of China

March 30, 2018

We have served as the Company s auditor since 2003.

Table of Contents

51JOB, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

	Note	2015	2016	2017	2017
		RMB	RMB	RMB	US$ (Note 2(c))
		(in thousands, except share and per share data)			
Revenues:					
Online recruitment services		1,356,442	1,547,143	1,871,700	287,675
Print advertising		5,328			
Other human resource related revenues		740,119	825,552	1,009,515	155,160
Total revenues		2,101,889	2,372,695	2,881,215	442,835
Less: Business tax and surcharges	2(k)	(46,669)	(34,361)	(32,623)	(5,014)
Net revenues		2,055,220	2,338,334	2,848,592	437,821
Cost of services(1)	2(l)	(569,979)	(663,001)	(763,440)	(117,339)
Gross profit		1,485,241	1,675,333	2,085,152	320,482
Operating expenses(1):					
Sales and marketing	2(m)	(654,468)	(783,492)	(917,784)	(141,061)
General and administrative		(263,067)	(280,002)	(296,608)	(45,588)
Total operating expenses		(917,535)	(1,063,494)	(1,214,392)	(186,649)
Income from operations		567,706	611,839	870,760	133,833
Gain (Loss) from foreign currency translation		(55,857)	238	3,630	558
Interest and investment income, net		93,548	58,933	77,009	11,836
Change in fair value of convertible senior notes	13	67,168	(69,439)	(496,175)	(76,261)
Other income, net	2(x)	71,533	98,315	87,032	13,377
Income before income tax expense		744,098	699,886	542,256	83,343
Income tax expense	10	(126,301)	(134,699)	(169,493)	(26,051)
Net income		617,797	565,187	372,763	57,292
Net loss (income) attributable to non-controlling interests		260	791	(874)	(134)
Net income attributable to 51job, Inc.		618,057	565,978	371,889	57,158
Net income		617,797	565,187	372,763	57,292
Other comprehensive income:					
Foreign currency translation adjustments		890	984	(6,037)	(928)
Unrealized gain on available-for-sale securities, net of tax effect of nil, RMB9,625 and RMB36,900 in 2015, 2016 and 2017, respectively	16		28,876	110,702	17,015
Total comprehensive income		618,687	595,047	477,428	73,379
Comprehensive loss (income) attributable to non-controlling interests		260	791	(874)	(134)
Comprehensive income attributable to 51job, Inc.		618,947	595,838	476,554	73,245
Earnings per share:	15				
Basic		10.71	9.74	6.19	0.95
Diluted		10.41	9.68	6.08	0.93

Weighted average number of common shares outstanding:				
Basic	57,714,850	58,132,976	60,087,306	60,087,306
Diluted	62,498,651	58,474,068	61,150,413	61,150,413

(1) Share-based compensation:				
Included in cost of services	(13,770)	(14,080)	(14,029)	(2,156)
Included in operating expenses				
Sales and marketing	(11,837)	(12,104)	(12,060)	(1,854)
General and administrative	(60,338)	(59,886)	(59,879)	(9,203)

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

Table of Contents

51JOB, INC.

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 2016 AND 2017

	Note	2016 RMB	2017 RMB	2017 US$ (Note 2(c))
		(in thousands, except share and per share data)		
ASSETS				
Current assets:				
Cash	2(d)	1,921,074	2,292,476	352,347
Restricted cash	2(d)	389	249	38
Short-term investments	2(f)	4,159,318	4,839,550	743,825
Accounts receivable (net of allowance for doubtful accounts of RMB6,144 and RMB5,384 as of December 31, 2016 and 2017, respectively)	4	111,246	186,861	28,720
Prepayments and other current assets	5	527,558	559,105	85,933
Total current assets		6,719,585	7,878,241	1,210,863
Non-current assets:				
Long-term investments	2(f)	189,017	433,886	66,687
Property and equipment, net	6	526,541	497,845	76,517
Goodwill	7	217,394	1,021,454	156,995
Intangible assets, net	8	73,620	162,024	24,903
Other long-term assets		8,988	17,370	2,670
Deferred tax assets, non-current	10	765	12,912	1,985
Total non-current assets		1,016,325	2,145,491	329,757
Total assets		7,735,910	10,023,732	1,540,620
LIABILITIES, MEZZANINE EQUITY AND EQUITY				
Current liabilities (including amounts of the consolidated VIEs and VIEs subsidiaries without recourse to the primary beneficiaries of RMB327 and RMB62,795 as of December 31, 2016 and 2017, respectively):	2(b)			
Accounts payable		32,516	35,532	5,462
Salary and employee related accrual		103,559	134,966	20,744
Taxes payable		155,786	230,734	35,463
Advance from customers		655,416	937,981	144,165
Convertible senior notes, current	13	1,257,709		
Other payables and accruals	9	498,036	703,441	108,117
Total current liabilities		2,703,022	2,042,654	313,951
Non-current liabilities (including amounts of the consolidated VIEs and VIEs subsidiaries without recourse to the primary beneficiaries of RMB9,625 and RMB49,860 as of December 31, 2016 and 2017, respectively):				
Deferred tax liabilities, non-current	10	57,166	121,348	18,651
Convertible senior notes, non-current	13		1,667,967	256,362
Total non-current liabilities		57,166	1,789,315	275,013
Total liabilities		2,760,188	3,831,969	588,964
Commitments and contingencies	17			
Mezzanine equity:				

Redeemable non-controlling interests	18		228,230	35,078
Shareholders equity:				
Common shares (US$0.0001 par value per share; 500,000,000 shares authorized, 60,062,385 and 61,853,004 shares issued and outstanding as of December 31, 2016 and 2017, respectively)		49	50	8
Additional paid-in capital		1,299,350	1,809,732	278,151
Statutory reserves	2(q)	13,360	13,874	2,132
Accumulated other comprehensive income		32,282	136,947	21,048
Retained earnings		3,622,402	3,993,777	613,832
Total 51job, Inc. shareholders equity		4,967,443	5,954,380	915,171
Non-controlling interests		8,279	9,153	1,407
Total equity		4,975,722	5,963,533	916,578
Total liabilities, mezzanine equity and equity		7,735,910	10,023,732	1,540,620

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

Table of Contents

51JOB, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

	Common shares Number of shares	Par value RMB	Additional paid-in capital RMB	Statutory reserves RMB	Accumulated other comprehensive income RMB	Retained earnings RMB	Total 51job, Inc. shareholders equity RMB	Non-controlling interests RMB	Total equity RMB
	(in thousands, except share data)								
Balance as of December 31, 2014	59,004,772	48	1,040,639	10,785	1,532	2,440,942	3,493,946		3,493,946
Exercise of share options	838,809	0	83,476				83,476		83,476
Share-based compensation			85,945				85,945		85,945
Repurchase and retirement of common shares	(898,950)	(0)	(157,272)				(157,272)		(157,272)
Appropriation of statutory reserves				2,447		(2,447)			
Foreign currency translation adjustments					890		890		890
Net income (loss)						618,057	618,057	(260)	617,797
Acquisition of a subsidiary								9,330	9,330
Balance as of December 31, 2015	58,944,631	48	1,052,788	13,232	2,422	3,056,552	4,125,042	9,070	4,134,112
Exercise of share options	1,117,754	1	160,492				160,493		160,493
Share-based compensation			86,070				86,070		86,070
Appropriation of statutory reserves				128		(128)			
Foreign currency translation adjustments					984		984		984
Unrealized gain on available-for-sale securities, net of tax effect of RMB9,625					28,876		28,876		28,876
Net income (loss)						565,978	565,978	(791)	565,187
Balance as of December 31, 2016	60,062,385	49	1,299,350	13,360	32,282	3,622,402	4,967,443	8,279	4,975,722
Exercise of share options	2,147,819	1	424,449				424,450		424,450
			85,968				85,968		85,968

Share-based compensation									
Settlement of zero-strike call options and retirement of common shares	(357,200)	(0)	(35)				(35)		(35)
Appropriation of statutory reserves				514		(514)			
Foreign currency translation adjustments					(6,037)		(6,037)		(6,037)
Unrealized gain on available-for-sale securities, net of tax effect of RMB36,900					110,702		110,702		110,702
Net income						371,889	371,889	874	372,763
Balance as of December 31, 2017	61,853,004	50	1,809,732	13,874	136,947	3,993,777	5,954,380	9,153	5,963,533
Balance as of December 31, 2017 (US$ Note 2(c))	61,853,004	8	278,151	2,132	21,048	613,832	915,171	1,407	916,578

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

Table of Contents

51JOB, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

	2015	2016	2017	2017
	RMB	RMB	RMB	US$ (Note 2(c))
		(in thousands)		
Cash flows from operating activities:				
Net income for the year	617,797	565,187	372,763	57,292
Adjustments for:				
Share-based compensation	85,945	86,070	85,968	13,213
Depreciation	49,781	53,754	53,422	8,211
Amortization of intangible assets	6,167	9,022	10,245	1,574
Allowance for doubtful accounts	5,515	7,548	15,394	2,366
Loss due to disposal of fixed assets	109	122	690	106
(Gain) Loss from foreign currency translation	55,617	14,749	(2,248)	(346)
Change in fair value of convertible senior notes	(67,168)	69,439	496,175	76,261
Deferred tax expense	18,129	14,419	12,787	1,965
Changes in operating assets and liabilities, net of effects of acquisition:				
Increase in accounts receivable	(25,030)	(20,071)	(74,356)	(11,428)
Increase in prepayments and other current assets	(68,165)	(31,686)	(35,128)	(5,399)
Increase in accounts payable	750	7,474	2,565	394
Increase in salary and employee related accrual	14,805	19,374	18,087	2,780
Increase in taxes payable	14,897	46,200	74,436	11,441
Increase in advance from customers	72,716	91,795	234,523	36,046
Increase in other payables and accruals	81,254	156,156	183,657	28,228
Decrease (Increase) in other long-term assets	1,331	(2,675)	(7,277)	(1,119)
Net cash provided by operating activities	864,450	1,086,877	1,441,703	221,585
Cash flows from investing activities:				
Purchase of short-term investments	(396,789)	(305,823)	(576,452)	(88,599)
Cash paid for long-term investments	(22,800)	(1,000)	(97,267)	(14,950)
Cash paid for acquisitions, net of cash acquired	(231,531)	(8,450)	(734,895)	(112,951)
Cash paid for available-for-sale securities		(126,716)		
Purchase of property and equipment	(86,434)	(20,328)	(23,655)	(3,636)
Purchase of intangible assets	(6,128)	(26,276)	(1,987)	(305)
Purchase of other long-term assets		(735)		
Net cash used in investing activities	(743,682)	(489,328)	(1,434,256)	(220,441)
Cash flows from financing activities:				
Repurchase and retirement of common shares	(157,272)			
Settlement of zero-strike call options and retirement of common shares			(35)	(5)
Proceeds from the exercise of share options	83,476	160,493	424,450	65,237
Net cash provided by (used in) financing activities	(73,796)	160,493	424,415	65,232
Effect of foreign exchange rate changes on cash	4,284	37,680	(60,460)	(9,293)
Net increase in cash	51,256	795,722	371,402	57,083
Cash, beginning of year	1,074,096	1,125,352	1,921,074	295,264
Cash, end of year	1,125,352	1,921,074	2,292,476	352,347

Supplemental disclosure of cash flow information:				
Cash paid during the years for income taxes	113,066	107,239	121,929	18,740
Cash paid for interest, net of amounts capitalized	34,445	36,773	38,377	5,898
Supplemental disclosure of non-cash investing activities:				
Accrual related to purchase of property, equipment and software	(1,459)	(2,405)	(1,043)	(160)
Unpaid cash consideration for business combinations	(16,900)	(8,450)	(27,923)	(4,292)
Supplemental disclosure of non-cash financing activities:				
Restricted cash and payables related to the exercise of share options, end of year	13,059	389	249	38

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

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

1. ORGANIZATION AND NATURE OF OPERATIONS

The accompanying consolidated financial statements include the financial statements of 51job, Inc. (the Company), which was incorporated in the Cayman Islands in March 2000, its subsidiaries and certain variable interest entities (VIEs).

The Company, its subsidiaries and VIEs are hereinafter collectively referred to as the Group. The Group is an integrated human resource services provider in the People s Republic of China (the PRC or China) and is principally engaged in recruitment related advertising services, including Internet recruitment services and, historically, print advertising services. The Group also provides other human resource related services, such as business process outsourcing, training, campus recruitment and placement services.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reported years. Management s significant estimates include those related to allowances for accounts receivable, allowances for prepayments and other current assets, estimated useful lives of property and equipment and intangible assets, fair values of options to purchase the Company s common shares, fair values of financial instruments, impairment of long-lived assets, long-term investments and goodwill, the purchase price allocation and fair value of non-controlling interests with respect to business combinations, and deferred tax valuation allowance. Management bases the estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may materially differ from those estimates.

(b) ***Basis of Consolidation***

The consolidated financial statements include the financial statements of the Company, its subsidiaries and the VIEs of which the Company is the primary beneficiary. All significant transactions and balances between the Company, its subsidiaries and VIEs have been eliminated upon consolidation.

A subsidiary is an entity in which the Company, directly or indirectly, controls more than one half of the voting power; has the power to appoint or remove the majority of the members of the board of directors; to cast majority of votes at the meeting of the board of directors; or to govern the financial and operating policies of the investee under a statute or agreement among the shareholders or equity holders.

The Company has adopted Accounting Standards Codification (ASC) 810 Consolidation for all periods presented. It requires a VIE to be consolidated by the reporting entity that has a controlling financial interest in the VIE, and thus is the VIE s primary beneficiary. An entity is considered to be a VIE if certain conditions are present, such as if the equity investors in the entity do not have the characteristics of a controlling financial interest or the entity does not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In determining whether the Company or its subsidiary has a controlling financial interest in a VIE, the Company considered whether the Company or its subsidiaries have the power to direct activities that most significantly impact the VIE s economic performance, including the power to appoint senior management, right to direct company strategy, power to approve capital expenditure budgets, power to establish and manage ordinary business operation procedures and internal regulations and systems, and the right to receive benefits from the VIE that could potentially be significant to the VIE or the obligation to absorb losses of the VIE that could potentially be significant to the VIE.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

The Company s subsidiaries include the following:

- 51net.com Inc. (51net), incorporated in the British Virgin Islands in August 1999, which is wholly owned by the Company;
- 51net Beijing, incorporated in the Cayman Islands in April 2000, which wholly owns Qian Cheng Wu You Network Information Technology (Beijing) Co., Ltd. (WFOE), incorporated in the PRC in July 2000, which is wholly owned by the Company;
- 51net HR, incorporated in the Cayman Islands in April 2000, which owns 70% of Shanghai Wang Ju Human Resource Consulting Co., Ltd. (Wang Ju), incorporated in the PRC in October 2006, which is wholly owned by the Company; and
- Lagou Information Limited (Lagou), incorporated in the Cayman Islands in December 2013, which was acquired and became 66% owned by the Company in December 2017.

51net s principal subsidiaries include the following:

- Qianjin Network Information Technology (Shanghai) Co., Ltd. (Tech JV), incorporated in the PRC in January 2000, which is 50% owned by 51net;
- Wang Jin Information Technology (Shanghai) Co., Ltd. (Wang Jin), incorporated in the PRC in June 2004, which is wholly owned by 51net;
- Shanghai Wang Ju Advertising Co., Ltd., incorporated in the PRC in June 2007, which is wholly owned by 51net; and

- Wuhan Wang Cai Information Technology Co., Ltd., incorporated in the PRC in December 2009, which is wholly owned by Wang Jin.

Tech JV s principal subsidiaries include the following:

- Shanghai Qianjin Advertising Co., Ltd. (AdCo), incorporated in the PRC in June 2001, which is 80% owned by Tech JV;

- Shanghai Wang Cai Advertising Co., Ltd., incorporated in the PRC in April 2005, which is jointly owned by Tech JV and AdCo;

- Shanghai Qianjin Zhong Cheng Human Resources Co., Ltd., incorporated in the PRC in December 2010; which is wholly owned by Tech JV;

- Shanghai Yishu Information Technology Co., Ltd., incorporated in the PRC in May 2007; which was acquired and became wholly owned by Tech JV in April 2015;

- Beijing Zhiding Youyuan Management Consulting Co., Ltd., incorporated in the PRC in September 2010, which was acquired and became 60% owned by Tech JV in June 2015; and

- Shanghai Pinyi Information Technology Co., Ltd., incorporated in the PRC in November 2010; which was acquired and became wholly owned by Tech JV in April 2015.

The Group s VIEs include the following:

- Beijing Run An Information Consultancy Co., Ltd. (Run An), incorporated in the PRC in January 1997, which wholly owns Beijing Qian Cheng Si Jin Advertising Co., Ltd. (Qian Cheng), owns 30% of Wang Ju, and owns 60% of Beijing Lagou Network Information Technology Co, Ltd., incorporated in the PRC in March 2013 and acquired by Run An in December 2017; and

- Qian Cheng, incorporated in the PRC in February 1999, which owns 20% of AdCo and effectively owns 50% of Tech JV by direct and indirect ownership through Qian Cheng s wholly owned subsidiary Wuhan Mei Hao Qian Cheng Advertising Co., Ltd. (Wuhan AdCo), incorporated in the PRC in August 2001.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

As of December 31, 2017 and for all years presented, the Company is the primary beneficiary of two VIEs, Run An and Qian Cheng, which were in existence prior to the establishment of the Company and are considered predecessors of the Group. The Company does not have any direct equity ownership in the VIEs and VIEs subsidiaries, but through certain arrangements as described below, the Company receives all of the economic benefits, absorbs all of the expected losses and has the power to direct activities that are significant to the VIEs. In addition, through a call option agreement between 51net and Qian Cheng, 51net is able to purchase the equity interests in Tech JV that are held by Qian Cheng and Wuhan AdCo as well as the equity interests in AdCo and its subsidiaries that are held by Qian Cheng. As a result, Run An, Qian Cheng and all of Tech JV and AdCo are included in the consolidated financial statements, and the Company effectively holds all of the equity interests in its subsidiaries including the VIEs.

Run An holds a human resource service permit issued by the Beijing human resources and social security bureau which allows it to provide recruitment, training and human resource consulting services. Run An is jointly owned by two long-time members of the Company s senior management team, Jingwu Chen, who replaced a previous nominee shareholder in 2017, and Tao Wang. As of December 31, 2017, the registered capital of Run An was RMB6,000 and its accumulated loss was RMB3,920.

Qian Cheng holds an advertisement license. Qian Cheng is wholly owned by Run An. As of December 31, 2017, the registered capital of Qian Cheng was RMB1,500 and its retained earnings were RMB5,589.

As the consolidated VIEs are incorporated as limited liability companies under the PRC Company Law, creditors of the VIEs do not have recourse to the general credit of the Company. Currently, there is no contractual arrangement that could require the Company to provide additional financial support to the consolidated VIEs, but the Company may provide such support on a discretionary basis in the future, which could expose the Company to loss.

The Group has entered into various agreements as related to its VIEs. The key provisions of the agreements with the Company or its subsidiaries and the VIEs or its shareholders are as follows:

Technical and Consulting Service Agreements. WFOE has entered into technical and consulting service agreements with Run An and Qian Cheng, respectively, under which WFOE has the exclusive right, subject to certain exceptions, to provide technical services to Run An and Qian Cheng for service fees. WFOE did not issue any invoices to either Run An or Qian Cheng, and neither Run An nor Qian Cheng paid any fees to WFOE for the years ended December 31, 2015, 2016 and 2017. The technical and consulting service agreements with WFOE are valid to September 11, 2027 under the Run An agreement and valid to May 2, 2034 under the Qian Cheng agreement, and can only be terminated by WFOE during the term. Such term is renewable upon written consent of the parties. Although the renewal is upon mutual consent, WFOE may, through its power of attorney, direct Run An and, through Run An, cause Qian Cheng to renew the technical and consulting service agreements upon expiration.

Equity Pledge Agreement. As security for the obligations of Run An under the technical and consulting service agreement and the obligations of Run An and its shareholders under the exclusive purchase option agreement described below, the shareholders of Run An have pledged all of their equity interest in Run An to WFOE. According to the pledge agreement, WFOE has the right to dispose of the pledged equity pursuant to PRC law in the event of default by Run An or its shareholders as provided in the pledge agreement. Additionally, the shareholders of Run An have agreed that they will not dispose of the pledged equity or take any actions that will prejudice WFOE s interest under the equity pledge agreement. The equity pledge agreement among WFOE, Run An and its shareholders was entered into on September 4, 2017 and shall expire two years after the fulfillment of all obligations under the Run An technical and consulting service agreement and the exclusive purchase option agreement. This pledge agreement, in combination with the exclusive purchase option agreement, contains content that is substantially the same as the pledge agreements entered into between WFOE and Run An s shareholders in September 2007 and January 2014, and between WFOE and Qian Cheng s shareholders in May 2004. The pledge of the equity interest by the shareholders of Run An to WFOE has been registered with the relevant bureau of the PRC State Administration for Industry and Commerce.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

Exclusive Purchase Option Agreement. WFOE has entered into an exclusive purchase option agreement with the shareholders of Run An, dated as of January 27, 2014, and supplemented and amended as of September 4, 2017, under which WFOE or its designee is granted an irrevocable option to purchase all or a portion of the equity interests in Run An at any time by issuing a written notice to the shareholders, subject to compliance with applicable PRC laws and regulations. The purchase price shall be equal to the contribution actually made by the shareholder for his equity interest in Run An. If the lowest price permitted under PRC law is above the contribution actually made by the shareholder, the premium shall be paid to Tech JV in accordance with the terms of the loan agreements described below. The exclusive purchase option agreement has the same term as the Run An technical and consulting service agreement. WFOE also has the exclusive right to terminate the agreement at any time by delivering a written notice to the shareholders of Run An.

Powers of Attorney. In conjunction with the signing of the equity pledge agreement and the exclusive purchase option agreement, each of the shareholders of Run An has signed an irrevocable power of attorney to appoint WFOE, as attorney-in-fact to vote, by itself or any other person to be designated at its discretion, on all matters of Run An that need to be decided by its shareholders. Because Qian Cheng is a wholly owned subsidiary of Run An and Wuhan AdCo is a wholly owned subsidiary of Qian Cheng, through controlling all material matters of Run An (including but not limited to all material operational matters and the appointment and removal of directors and senior management), WFOE also has indirect control on all material matters of Qian Cheng and Wuhan AdCo. Each power of attorney was entered into on January 27, 2014, and supplemented and amended as of September 4, 2017, and will remain effective for as long as Run An exists. The shareholders of Run An are not entitled to terminate or amend the terms of the power of attorney without prior written consent from WFOE.

Loan Agreements. Tech JV has entered into loan agreements dated as of September 11, 2007, and supplemented and amended as of September 4, 2017, for an aggregate amount of RMB6,000 with the shareholders of Run An, with the sole and exclusive purpose to fund the capitalization of Run An. The loans can be repaid only with the proceeds received from the transfer of the shareholders equity interest in Run An to Tech JV or its designee. The interest-free loan agreements are valid to September 11, 2027, and the term may be extended upon written consent of the parties.

Call Option Agreement. 51net has entered into a call option agreement with Qian Cheng dated as of August 1, 2002, and supplemented and amended as of May 3, 2004 and August 1, 2012, under which 51net or its designee is granted an irrevocable option to purchase all of Qian Cheng s equity interest in Tech JV and AdCo for RMB1,200 or, if such purchase price is not permissible under the applicable PRC laws, the lowest price permitted under then applicable PRC laws. In addition, Qian Cheng granted 51net an irrevocable option to purchase any and all of its equity interests in the subsidiaries of AdCo at the lowest price permitted under PRC laws. The call option agreement is valid to July 31, 2022, and the term may be extended upon written consent of the parties.

Management monitors the regulatory risk associated with these contractual arrangements. The Company s PRC legal counsel has advised management that these contractual arrangements are not in violation of existing PRC laws, rules and regulations in all material aspects. Based on such advice and management s knowledge and experience, the Company believes that its contractual arrangements with its consolidated VIEs and their shareholders are valid, legally binding and in compliance with current PRC laws. However, there are substantial uncertainties regarding the interpretation and application of current or future PRC laws, rules and regulations that could limit the Company s ability to enforce these contractual arrangements. Management monitors the regulatory risk associated with these contractual arrangements. See Note 19 for further discussion.

Summary financial information of the Group s VIEs and VIEs subsidiaries included in the consolidated financial statements is as follows:

	As of December 31,	
	2016 RMB	2017 RMB
Total assets	195,289	268,484
Total liabilities	9,952	112,655

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

	For the year ended December 31,		
	2015 RMB	2016 RMB	2017 RMB
Total revenues	592		
Net loss	(1,167)	(2,300)	(4,088)

	For the year ended December 31,		
	2015 RMB	2016 RMB	2017 RMB
Net cash provided by (used in) operating activities	(568)	1,257	(7,131)
Net cash provided by (used in) investing activities		(126,716)	4,152
Net cash provided by financing activities		126,745	3,334
Net increase (decrease) in cash	(568)	1,286	355
Cash, beginning of year	6,809	6,241	7,527
Cash, end of year	6,241	7,527	7,882

(c) Foreign Currencies

The Group s functional and reporting currency is the Renminbi (RMB). Transactions denominated in currencies other than RMB are translated into RMB at the exchange rates quoted by the People s Bank of China prevailing at the dates of the transactions. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations and comprehensive income. Monetary assets and liabilities denominated in foreign currencies are translated into RMB using the applicable exchange rates quoted by the People s Bank of China at the balance sheet dates. All such exchange gains and losses are included in the consolidated statements of operations and comprehensive income. The exchange differences for translation of group companies balances where RMB is not their functional currency are included in cumulative translation adjustments, which is a separate component of shareholders equity in the consolidated financial statements.

The unaudited United States dollar (US$) amounts disclosed in the accompanying financial statements are presented solely for the convenience of the readers. Translations of amounts from RMB into US$ for the convenience of the reader were calculated at the rate of US$1.00 = RMB6.5063 on December 29, 2017, representing the noon buying rate in The City of New York for cable transfers of RMB as certified for customs purposes by the Federal Reserve Bank of New York. No representation is made that the RMB amounts could have been, or could be, converted into US$ at that rate on December 29, 2017, or at any other rate.

(d) Cash and Restricted Cash

Cash represents cash on hand and demand deposits placed with banks or other financial institutions. Restricted cash represents cash proceeds from the exercise of share options by the Company s employees, executives and directors held in a bank account which have yet to be transmitted to them. Included in the cash and restricted cash balances as of December 31, 2016 and 2017 are amounts denominated in United States dollars totaling US$193,254 and US$125,450, respectively (equivalent to approximately RMB1,340,603 and RMB819,715, based on the RMB to US$ exchange rate quoted by the People s Bank of China on December 30, 2016 and December 29, 2017, respectively). The Group receives substantially all of its revenues in RMB, which currently is neither a freely convertible currency nor can it be freely remitted out of China.

(e) Accounts Receivable

Accounts receivable is presented net of allowance for doubtful accounts. The Company provides general and specific provisions for bad debts when facts and circumstances indicate that the receivable is unlikely to be collected. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

(f) Investments

The Group s short-term investments consist of time deposits with original maturities between three months and one year with banks in the PRC and Hong Kong, and investment products issued by financial institutions in the PRC with a variable interest rate indexed to the performance of underlying assets.

The Group s long-term investments consist of cost method and available-for-sale investments.

Cost Method Investments

For investees over which the Group does not have significant influence and a controlling interest, the Group accounts for these investments under the cost method. The Group reviews its cost method investments for other-than-temporary impairment by considering available quantitative and qualitative factors, such as current market conditions and the operating performance of the investees. No other-than-temporary impairment charge was incurred in the years ended December 31, 2015, 2016 and 2017.

The Group s cost method long-term investments consist of a number of small, non-controlling equity investments in companies that provide services related to the Group s operations or the overall human resources industry. In the year ended December 31, 2016, the Group made long-term investments totaling RMB1,000 for a 5% equity interest in each of 10 companies that provide business process outsourcing services in China. In the year ended December 31, 2017, the Group made long-term investments including RMB96,967 for a 9.5% equity interest in a mobile-based platform focused on short-term, on-demand work opportunities in the United States and a total of RMB300 for a 5% equity interest in each of three companies that provide business process outsourcing services in China.

Available-for-Sale Investments

Available-for-sale investments are carried at their fair value at each balance sheet date and changes in fair value are reflected in the consolidated statements of operations and comprehensive income.

In September 2016, the Group completed an investment of RMB126,716 for a 15% equity interest in Shanghai Gaodun Education & Training Co., Ltd. (Golden Finance), a provider of online and offline accounting and finance training courses in China. The Group s shares in Golden Finance have liquidation preference, and the Group has a right to demand redemption of its investment. Accordingly, due to the redemption option available to the Group, the Golden Finance investment was determined to be a debt, which was classified as available-for-sale security measured at fair value. Unrealized gain net of tax of RMB28,876 and RMB110,702 associated with the Golden Finance investment was included in other comprehensive income in the years ended December 31, 2016 and 2017, respectively.

(g) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis to allocate the cost of the assets to their estimated residual value over the following estimated useful lives:

	Estimated useful lives
Land use rights	32.42 to 50 years
Building	20 years
Leasehold improvements	Lesser of the lease period or the estimated useful life
Electronic equipment	3 to 5 years
Furniture and fixtures	5 years
Motor vehicles	5 years
Other assets	5 years

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

(h) Business Combinations

U.S. GAAP requires that all business combinations not involving entities or businesses under common control be accounted for under the purchase method. The Group has adopted ASC 805 Business Combinations, and the cost of an acquisition is measured as the aggregate of the fair values at the date of exchange of the assets given, liabilities incurred and equity instruments issued. The transaction costs directly attributable to the acquisition are expensed as incurred. Identifiable assets, liabilities and contingent liabilities acquired or assumed are measured separately at their fair value as of the acquisition date, irrespective of the extent of any non-controlling interests. The excess of the (i) the total of cost of acquisition, fair value of the non-controlling interests and acquisition date fair value of any previously held equity interest in the acquiree over (ii) the fair value of the identifiable net assets of the acquiree is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of operations and comprehensive income.

The determination and allocation of fair values to the identifiable assets acquired and liabilities assumed is based on various assumptions and valuation methodologies requiring considerable management judgment. The most significant variables in these valuations are discount rates, the number of years on which to base the cash flow projections, as well as the assumptions and estimates used to forecast the future cash inflows and outflows. Management determines discount rates to be used based on the risk inherent in the related activity s current business model and industry comparisons. Although management believes that the assumptions applied in the determination are reasonable based on information available at the date of acquisition, actual results may differ from the forecasted amounts and the difference could be material.

A non-controlling interest is recognized to reflect the portion of a subsidiary s equity which is not attributable, directly or indirectly, to the Company. When the non-controlling interest is contingently redeemable upon the occurrence of a conditional event, which is not solely within the control of the Company, the non-controlling interest is classified as mezzanine equity. Consolidated net income on the consolidated statements of operations and comprehensive income includes the net income (loss) attributable to non-controlling interests and mezzanine equity holders when applicable. Net income (loss) attributable to mezzanine equity holders is included in net income (loss) attributable to non-controlling interests on the consolidated statements of operations and comprehensive income, while it is excluded from the consolidated statements of changes in shareholders equity. For the year ended December 31, 2017, there was no net income or loss attributable to mezzanine equity holders. The cumulative results of operations attributable to non-controlling interests are also recorded as non-controlling interests in the Company s consolidated balance sheets. Cash flows related to transactions with non-controlling interests are presented under financing activities in the consolidated statements of cash flows when applicable.

(i) Goodwill and Intangible Assets

Goodwill

Goodwill represents the excess of the total cost of the acquisition, the fair value of any non-controlling interests and the acquisition date fair value of any previously held equity interest in the acquiree over the fair value of the identifiable tangible and intangible assets acquired and liabilities assumed of the acquired entity as a result of the Company s acquisitions of interests in its subsidiaries and VIEs. Goodwill is not amortized but is tested for impairment on an annual basis, or more frequently if events or changes in circumstances indicate that it might be impaired. The Company first assesses qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. In the qualitative assessment, the Company considers primary factors such as industry and market considerations, overall financial performance of the reporting unit and other specific information related to the operations. Based on the qualitative assessment, if it is more likely than not that the fair value of each reporting unit is less than the carrying amount, the quantitative impairment test is performed.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

In performing the two-step quantitative impairment test, the first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit s goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for the purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities.

Application of a goodwill impairment test requires significant management judgment, including the identification of reporting units, assigning assets, liabilities and goodwill to reporting units, and determining the fair value of each reporting unit. The Company estimates the fair value of the reporting unit using a discounted cash flow model. This valuation approach considers various assumptions including projections of future cash flows, perpetual growth rates and discount rates. The assumptions about future cash flows and growth rates are based on management s assessment of a number of factors, including the reporting unit s recent performance against budget, performance in the market that the reporting unit serves, as well as industry and general economic data from third party sources. Discount rate assumptions reflect an assessment of the risk inherent in those future cash flows. Changes to the underlying businesses could affect the future cash flows, which in turn could affect the fair value of the reporting unit. Management performs its annual goodwill impairment test on December 31. No impairment of goodwill was recognized in the years ended December 31, 2015, 2016 and 2017.

Intangible Assets

Intangible assets purchased and intangible assets arising from acquisitions of subsidiaries are recognized and measured at fair value upon acquisition. The Company s purchased intangible assets include computer software, acquired technology and licenses, which are amortized on a straight-line basis over their estimated useful lives, ranging from 3 to 10 years. Separately identifiable intangible assets arising from acquisitions consist of trade names, technology and customer relationships, which are amortized on a straight-line basis over their estimated useful lives of 5 to 20 years. The estimated life of intangible assets subject to amortization is reassessed if circumstances occur that indicate the life has changed. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. No impairment of intangible assets was recognized in the years ended December 31, 2015, 2016 and 2017.

(j) *Impairment of Long-Lived Assets Other Than Goodwill*

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that carrying amount of an asset group may not be recoverable. The recoverability of an asset group is based on the undiscounted future cash flows the asset group is expected to generate and recognize an impairment loss when the estimated undiscounted future cash flows expected to result from the use of the asset group plus net proceeds expected from the disposition of the asset group, if any, are less than the carrying value of the asset group. If the Group identifies an impairment, the Group reduces the carrying amount of the asset group to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values. No impairment of long-lived assets was recognized in the years ended December 31, 2015, 2016 and 2017.

(k) *Revenue Recognition*

Online Recruitment Services Revenues

The Group provides online recruitment advertising and other technical services through several websites, including *www.51job.com*, *www.yingjiesheng.com* and *www.51jingying.com*. The average display period of online recruitment services normally ranges from one week to one year. Fees for its online recruitment advertisement and other technical services are recognized as revenue ratably over the display period of the contract or when services are provided, collectibility is reasonably assured, and other criteria in accordance with ASC 605 Revenue Recognition (ASC 605) are met. For a transaction involving multiple services, the Company recognizes revenue at relative fair value which is determined based on the Company s regular selling prices charged in unbundled arrangements. Cash received in advance of services are recognized as advance from customers.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

Print Advertising Revenues

The Group provided recruitment advertising services through a weekly newspaper in the PRC. Arrangements for recruitment advertisement on the weekly newspaper were generally short-term in nature. Fees for these types of print recruitment advertising services were recognized as revenue when collectibility was reasonably assured, upon the publication of the advertisements and when other criteria in accordance with ASC 605 were met. Cash received in advance of services were recognized as advance from customers. As of December 31, 2015, the Group had ceased all print advertising operations.

Other Human Resource Related Revenues

The Group also provides other value-added human resource services, such as business process outsourcing, training, campus recruitment, placement and other services. Revenue is recognized when (i) persuasive evidence of an agreement exists; (ii) services are rendered; (iii) the sales price and terms are fixed or determinable; and (iv) the collection of the receivable is reasonably assured, as prescribed by ASC 605.

Value-Added Tax, Business Tax and Surcharges

Effective January 1, 2012, the PRC State Council instituted a business tax to value-added tax (VAT) transformational pilot program in Shanghai. Under this program, industries subject to business tax were transitioned to VAT payers. As of May 1, 2016, the VAT program was expanded to cover all industries in the PRC, the VAT chain for all industries was completed, and the Company ceased paying business tax in the PRC.

Generally, the main businesses of the Group s PRC subsidiaries and VIEs are subject to VAT rates of 5% or 6%, and are permitted to offset input VAT supported by valid VAT invoices received from vendors against their VAT liability. VAT on the invoiced amount collected by the PRC subsidiaries and VIEs on behalf of tax authorities in respect of services provided, net of VAT paid for purchases, is recorded as taxes payable until it is paid to the tax authorities.

The Group s PRC subsidiaries and VIEs are also subject to certain government surcharges on the VAT payable in the PRC. In the consolidated statements of operations and comprehensive income, these surcharges are included under the account of business tax and surcharges, which is deducted from gross revenues to arrive at net revenues.

(l) Cost of Services

Cost of services consist primarily of payroll compensation and related employee costs, subcontracting fees and other expenses incurred by the Group which are directly attributable to the rendering of the Group s recruitment advertising and other human resource services.

(m) Sales and Marketing Expenses

Sales and marketing expenses consist primarily of the Group s sales and marketing personnel payroll compensation and related employee costs and advertising and promotion expenses. Advertising and promotion expenses generally represent the cost of promotions to create or stimulate a positive image of the Group or a desire for the Group s services. Advertising and promotion expenses are charged to the consolidated statements of operations and comprehensive income when incurred and totaled RMB123,745, RMB126,205 and RMB130,355 for the years ended December 31, 2015, 2016 and 2017, respectively.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

(n) Share-Based Compensation

The Company accounts for share-based compensation arrangements with employees in accordance with ASC 718 Compensation Stock Compensation. It requires the Company to measure at the grant date the fair value of the stock-based award and recognize compensation costs, net of estimated forfeitures, on a straight-line basis, over the requisite service period. The Company uses the Black-Scholes option pricing model to determine the fair value of stock options. Risk-free interest rates are based on U.S. Treasury yield for the terms consistent with the expected life of award at the time of grant. Expected life takes into account vesting and contractual terms, employee demographics and historical exercise behavior, which the Company believes are useful reference points. The assumption for expected dividend yield is consistent with the Company s current policy of no dividend payout. The Company estimates expected volatility at the date of grant based on historical volatilities of the market price of its American depositary shares (ADSs). Forfeiture rate is estimated based on historical forfeiture patterns and adjusted to reflect future change in circumstances and facts, if any. If actual forfeitures differ from those estimates, the Company may need to revise those estimates used in subsequent periods. The weighted average fair value per stock option on grant date is RMB68.90, RMB66.87 and RMB101.63 for the years ended December 31, 2015, 2016 and 2017, respectively.

For the years ended December 31, 2015, 2016 and 2017, the fair value of options granted was estimated with the following assumptions:

	2015	**2016**	**2017**
Risk-free interest rate	1.14%-1.49%	1.00%-1.70%	1.61%
Expected life (years)	4	4	4
Expected dividend yield	0%	0%	0%
Volatility	38%-42%	33%-34%	32%
Weighted average fair value per common share on date of option grant	US$31.40	US$34.27	US$56.68

(o) *Operating Leases*

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received by the Group from the leasing company, are charged to the consolidated statements of operations and comprehensive income on a straight-line basis over the lease periods.

(p) *Taxation*

The Company accounts for income taxes using the liability method. Under this method, deferred income taxes are recognized for the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities by applying enacted statutory rates applicable to future years in which the differences are expected to reverse. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax assets will not be realized.

The Company accounts for uncertainties in accordance with ASC 740-10-25 Income Taxes Overall Recognition. The Company recognizes a tax benefit associated with an uncertain tax position when, in management s judgment, it is more likely than not that the position will be sustained upon examination by a taxing authority. The Company has elected to classify interest and penalties related to an uncertain tax position, if any and when required, as general and administrative expenses. In the years ended December 31, 2015, 2016 and 2017, the Company did not record any interest and penalties associated with uncertain tax positions as there were no uncertain tax positions.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

(q) Statutory Reserves

With the exception of Tech JV which is 50% owned by 51net, a British Virgin Islands company, and Wang Ju which is majority owned by 51net HR, a Cayman Islands company, the Group s subsidiaries and VIEs incorporated in the PRC are required on an annual basis to allocate at least 10% of their after-tax profit, after the recovery of accumulated deficit to the statutory common reserve. The amount of allocation is calculated based on an entity s after-tax profit shown in its statutory financial statements which are prepared in accordance with PRC accounting standards and regulations until the reserve has reached 50% of the registered capital of each company. Once the total statutory common reserve fund reaches 50% of the registered capital of the respective companies, further appropriations are discretionary. The statutory common reserve fund is not distributable to shareholders except in the event of liquidation. Since 2008, the statutory common reserve fund for more than half of the Group s subsidiaries and VIEs incorporated in the PRC had reached 50% of the registered capital of the respective companies. As a result, no appropriations were made by these entities to their respective statutory reserve funds in the years ended December 31, 2015, 2016 and 2017. With the exception of a few entities, all remaining subsidiaries whose total statutory common reserve fund had not reached 50% of its respective registered capital had accumulative losses as of December 31, 2015, 2016 and 2017. As a result, these entities did not make appropriations to their statutory reserve funds in the years ended December 31, 2015, 2016 and 2017. During the years ended December 31, 2015, 2016 and 2017, the Group s subsidiaries made total appropriations to their statutory common reserve fund in the amount of RMB2,447, RMB128 and RMB514, respectively.

In addition, the Group s subsidiaries and VIEs incorporated in the PRC may, at the discretion of its board of directors, on an annual basis set aside the statutory common welfare fund, which can be used for staff welfare of the Group. No appropriations to the statutory common welfare fund were made for the years ended December 31, 2015, 2016 and 2017.

Appropriations to the statutory common reserve fund and the statutory common welfare fund are accounted for as a transfer from retained earnings to the statutory reserves.

There are no legal requirements in the PRC to fund these reserves by transfer of cash to any restricted accounts, and the Group does not do so. These reserves are not distributable as cash dividends.

(r) *Dividend*

Dividends are recognized when declared. PRC regulations currently permit payment of dividends only out of accumulated profits as determined in accordance with PRC accounting standards and regulations. Additionally, the Group s PRC subsidiaries and VIEs can only distribute dividends after they have met the PRC requirements for appropriation to statutory reserves. See Note 2(q). In addition, the net assets of the Group s subsidiaries and VIEs associated with their paid-in capital are not distributable in the form of dividends. Aggregate net assets of the Group s PRC subsidiaries and VIEs not distributable in the form of dividends to the parent as a result of the aforesaid PRC regulations and related to the paid-in capital and statutory reserves were approximately RMB522,078 and RMB522,592, or 10.5% and 8.4% of total consolidated net assets as of December 31, 2016 and 2017, respectively. However, the PRC subsidiaries may transfer such net assets to the Company by other means, including through royalty and trademark license agreements or certain other contractual agreements, at the discretion of the Company without third party consent.

(s) *Earnings Per Share*

In accordance with ASC 260 Earnings Per Share, basic earnings per share is computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated by dividing net income attributable to common shareholders, as adjusted for the change in income resulting from the assumed conversion of securities or other contracts (i.e., zero-strike call option contracts) to common shares, by the weighted average number of common and dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of the common shares issuable upon the conversion of the convertible senior notes (using the if-converted method) and common shares issuable upon the exercise of outstanding share options (using the treasury stock method).

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

The common shares underlying the zero-strike call option contracts are excluded from both the basic and diluted earnings per share calculation as they are considered as deemed repurchased for the purpose of calculating both basic and diluted earnings per share. See Note 13.

(t) Fair Value Measurement of Financial Instruments

Fair value reflects the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participates at the measurement date in accordance with ASC 820 Fair Value Measurements and Disclosures (ASC 820). When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. ASC 820 clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosures about fair value measurements.

ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 Include other inputs that are directly or indirectly observable in the marketplace

Level 3 Unobservable inputs which are supported by little or no market activity

ASC 820 describes three main approaches to measuring the fair value of assets and liabilities: (i) market approach; (ii) income approach; and (iii) cost approach. The market approach uses prices and other relevant information generated from market transactions involving identical or comparable assets or liabilities. The income approach uses valuation techniques to convert future amounts to a single present value amount. The measurement is based on the value indicated by current market expectations about those future amounts. The cost approach is based on the amount that would currently be required to replace an asset.

Financial instruments of the Group are primarily comprised of cash, restricted cash, short-term investments, available-for-sale investments, receivables, payables, convertible senior notes and zero-strike call options.

As of December 31, 2016 and 2017, the carrying values of cash, restricted cash, accounts receivable and payables approximated their estimated fair values due to the short-term maturities of these instruments. Short-term investments in time deposits are categorized as Level 1 under the fair value hierarchy and the carrying values approximated their estimated fair values because such deposits bear market interest rates. Short-term investments in investment products are categorized as Level 2 under the fair value hierarchy and their fair values are based on quoted prices or other observable inputs in active markets.

The Group reports available-for-sale investments at fair value at each balance sheet date and changes in fair value are reflected in the consolidated statements of operations and comprehensive income. Fair value of the available-for-sale investments is measured using Level 3 inputs within the fair value hierarchy. In determining the fair value, the Group utilizes an income approach of a discounted cash flow model, which includes unobservable inputs such as future cash flows, growth rates and discount rates. These assumptions are inherently uncertain and subjective, and changes in any unobservable inputs may have a significant impact on the fair value. See Note 16 for the change in fair value of available-for-sale investments.

In accordance with ASC 820, the Company measures the convertible senior notes at fair value on a recurring basis. The Company reports the convertible senior notes at fair value at each balance sheet date and changes in fair value are reflected in the consolidated statements of operations and comprehensive income. Fair value of the convertible senior notes is measured using Level 1 inputs within the fair value hierarchy as they are based on quoted market prices that are currently available on a dealer market. See Note 13.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

Fair value of the zero-strike call options is measured using Level 2 inputs within the fair value hierarchy as they are based on market prices of the Company s publicly traded ADSs underlying the options. A change in fair value of the zero-strike call options was recognized in the year ended December 31, 2014 and reflected the difference in the closing stock price of the Company s ADSs as quoted on the NASDAQ Global Select Market between when the zero-strike call options were initially entered into in April 2014 and their inclusion in equity in June 2014. See Note 13.

In determining the debt issuance costs related to the convertible senior notes and zero-strike call options, the Company applied the accounting for the fair value of a share lending arrangement using Level 3 inputs. The fair value of a share lending arrangement represents the economic loss from the share lending arrangement over the expected term of the underlying zero-strike call option contract. The inputs used in calculating fair value of the share lending arrangement include the contract value of the zero-strike call options, the estimated long-term share lending commission rate and the expected term of the zero-strike call option contract. See Note 13.

(u) Segment Reporting

Based on the criteria established by ASC 280 Segment Reporting, the Group currently operates and manages its business as a single operating and single reportable segment. The Group s chief operating decision-maker (CODM) is the chief executive officer. The CODM reviews operating results to make decisions about allocating resources and assessing performance for the entire Group. The Group primarily generates its revenues from customers in the PRC, and assets of the Group are also located in PRC. Accordingly, no geographical segments are presented.

(v) Stock Repurchase

When the Company s common shares are repurchased for retirement, the excess of cost over par value is charged entirely to additional paid-in capital, limited to additional paid-in capital of the same issue being retired.

(w) *Comprehensive Income*

The Company has adopted ASC 220 Comprehensive Income. Other comprehensive income/loss is defined as the change in equity of a company during the period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. Accumulated other comprehensive income mainly consists of cumulative foreign currency translation adjustments and unrealized gains on available-for-sale securities.

(x) *Government Subsidies*

Government subsidies represent discretionary cash subsidies granted by the local government to encourage the development of certain enterprises that are established in the local special economic region. Cash subsidies have no defined rules and regulations to govern the criteria necessary for companies to enjoy the benefits and are recognized as other income when received and when all conditions for their receipt have been satisfied.

The Group recognized government subsidies of RMB70,625, RMB97,092 and RMB86,287 which was included in other income for the years ended December 31, 2015, 2016 and 2017, respectively.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

(y) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), a new standard on revenue which will supersede the revenue recognition requirements in ASC 605. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delays the effective date of ASU 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the implementation guidance on principal versus agent considerations. Further, in 2016, the FASB issued five amendments to the new standard. The new standard, as amended, sets forth a single comprehensive model for recognizing and reporting revenues. The new guidance requires the Company to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance requires the Company to apply the following steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the Company satisfies a performance obligation. The standard also requires additional financial statement disclosures that will enable users to understand the nature, amount, timing and uncertainty of revenues and cash flows relating to customer contracts. The standard is effective for fiscal years, and interim periods within those years, beginning on or after January 1, 2018. Early adoption is permitted but not before periods beginning on or after January 1, 2017. The Company expects to adopt the standard starting January 1, 2018. The standard allows for two methods of adoption: the full retrospective adoption, which requires the standard to be applied to each prior period presented, or the modified retrospective adoption, which requires the cumulative effect of adoption to be recognized as an adjustment to opening retained earnings in the period of adoption. The Company anticipates adopting the standard using the modified retrospective method. The Company has identified and evaluated all of its contracts with customers, and compared the requirements of the new standard with its current accounting policies. This includes an analysis of, among other things: the timing of revenue recognition, the allocation of value for performance obligations that might be bundled within contractual arrangements, and the method of recording revenue on a gross vs. net basis. The Company has also evaluated whether any revenue-related costs for commissions, customer acquisition or similar costs would be affected by the new standard. After performing this analysis, the Company does not expect the adoption of the new standard to have a material impact on its revenue recognition and consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). The main objective of this update is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 changes how entities measure certain equity investments and present changes in the fair value of financial liabilities measured under the fair value option that are attributable to their own credit. The guidance also changes certain disclosure requirements and other aspects of current U.S. GAAP. Further, in March 2018, the FASB issued Technical Corrections and Improvements to Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which provides further guidance on adjustments for observable transaction for equity securities without a readily determinable fair value and clarification on fair value option for liabilities instruments. ASU 2016-01 is effective for annual reporting periods, and interim periods within those years beginning after December 15, 2017. Early adoption by public entities is permitted only for certain provisions. The Company is in the process of evaluating the impact of ASU 2016-01 on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (ASU 2016-02). Under the new guidance, lessees will be required to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with earlier application permitted. The Company expects to adopt the new standard in the first quarter of 2019 on a modified retrospective basis and is currently in the process of evaluating the impact of ASU 2016-02 on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments Credit Losses (ASU 2016-13), which introduces new guidance for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments, including, but not limited to, trade and other receivables, held-to-maturity debt securities, loans and net investments in leases. The new guidance also modifies the impairment model for available-for-sale debt securities and requires the entities to determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. The standard also indicates that entities may not use the length of time a security has been in an unrealized loss position as a factor in concluding whether a credit loss exists. The ASU is effective for public companies for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is in the process of evaluating the impact of ASU 2016-13 on its consolidated financial statements.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

2. PRINCIPAL ACCOUNTING POLICIES (Continued)

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230), a consensus of the FASB s Emerging Issues Task Force (ASU 2016-15). The new guidance is intended to reduce the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The ASU is effective for public companies for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including interim periods within those fiscal years. An entity that elects early adoption must adopt all of the amendments in the same period. The guidance requires application using a retrospective transition method. The Company has adopted ASU 2016-15 in the current year and the adoption had no material impact on the Company s consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (ASU 2016-18). This ASU affects all entities that have restricted cash or restricted cash equivalents and are required to present a statement of cash flows under Topic 230. ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. This update will become effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, and early adoption is permitted in any interim or annual period. The Company is in the process of evaluating the impact of ASU 2016-18 on its consolidated statement of cash flows.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business (ASU 2017-01), which clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard introduces a screen for determining when assets acquired are not a business and clarifies that a business must include, at a minimum, an input and a substantive process that contribute to an output to be considered a business. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has adopted ASU 2017-01 in the current year and the adoption had no material impact on the Company s consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Simplifies Goodwill Impairment Test (ASU 2017-04), which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of the second step of the goodwill impairment test. As a result, under the ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The ASU is effective prospectively for fiscal years beginning after December 15, 2019. The Company is in the process of evaluating the impact of ASU 2017-04 on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation Stock compensation (Topic 718): Scope of modification accounting (ASU 2017-09), which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. ASU 2017-09 is effective prospectively for all companies for annual periods beginning on or after December 15, 2017, and early adoption is permitted. The Company has adopted ASU 2017-05 in the current year and the adoption had no material impact on the Company s consolidated financial statements.

3. ACQUISITIONS

Yingjiesheng.com

In April 2015, to expand its online operations, the Company acquired 100% of the equity interests in Shanghai Yishu Information Technology Co., Ltd. and Shanghai Pinyi Information Technology Co., Ltd. These two companies wholly own and operate Yingjiesheng.com (YJS), an established online recruitment website which focuses on college graduates and students in China. The total purchase price was RMB250,000 and was funded from the Company s existing cash resources. Beginning April 3, 2015, the date of acquisition, YJS has been fully consolidated into the Group s financial statements. The allocation of the purchase price at the date of acquisition is summarized as follows:

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

3. ACQUISITIONS (Continued)

	RMB
Net assets	10,524
Identifiable intangible assets:	
Trade names	35,600
Customer relationships	12,270
Goodwill	203,574
Deferred tax liabilities	(11,968)
Total	250,000

Beijing Zhiding Youyuan Management Consulting Co., Ltd.

In June 2015, to expand the scope of its training services, the Company completed an acquisition of a 60% equity interest in Beijing Zhiding Youyuan Management Consulting Co., Ltd. (Zhiding Youyuan), a provider of talent assessment and psychometric testing services in China. The total purchase price was RMB18,660 and was fully paid from the Company s existing cash resources. Beginning June 23, 2015, the date of acquisition, Zhiding Youyuan has been fully consolidated into the Group s financial statements. The allocation of the purchase price at the date of acquisition is summarized as follows:

	RMB
Net assets	14,170
Goodwill	13,820
Non-controlling interests	(9,330)
Total	18,660

Lagou Information Limited

In December 2017, to expand its online operations, the Company completed an acquisition of a 66% equity interest in Lagou Information Limited, an entity incorporated in the Cayman Islands. Lagou is the holding company of Beijing Lagou Network Technology Co., Ltd., which owns and operates a recruitment website focused on technology and engineering talent in China. The total purchase price was RMB782,594 and was funded from the Company s existing cash resources. Beginning December 26, 2017, the date of acquisition, Lagou has been fully consolidated into the Group s financial statements. As the acquisition date was just prior to end of the year, there was no material contribution from Lagou to the Company s consolidated statement of operations and comprehensive income for the year ended December 31, 2017. The allocation of the purchase price at the date of acquisition is summarized as follows:

	RMB
Net assets	125,026
Identifiable intangible assets:	
Trade names	60,183
Technology	35,979
Goodwill	804,060
Deferred tax liabilities	(14,424)
Redeemable non-controlling interests	(228,230)
Total	782,594

Based on the Company s assessment, the revenues and net earnings of YJS, Zhiding Youyuan and Lagou were not considered material to the Group. Pro forma results of operations for the acquisitions described above have not been presented because they are not material to the consolidated statements of operations and comprehensive income, either individually or in aggregate.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

4. ACCOUNTS RECEIVABLE

	2016 RMB	2017 RMB
Accounts receivable	117,390	192,245
Less: Allowance for doubtful accounts	(6,144)	(5,384)
	111,246	186,861

The movement of allowance for doubtful accounts is analyzed as follows:

	2015 RMB	2016 RMB	2017 RMB
Balance at beginning of period	1,103	3,290	6,144
Additions	3,792	6,705	5,738
Write-offs	(1,605)	(3,851)	(6,498)
Balance at end of period	3,290	6,144	5,384

5. PREPAYMENTS AND OTHER CURRENT ASSETS

	2016 RMB	2017 RMB
Rental and other deposits	677	3,116
Prepayments for rental and others	19,725	29,799
Employee advances	4,082	9,268
Payments made on behalf of customers	462,841	458,199
Prepaid insurance premium	958	1,035
Interest income receivable	37,344	51,374
Others	1,931	6,314
Total	527,558	559,105

Payments made on behalf of customers are associated with the operations of the Company s business process outsourcing services. The Company has remitted funds in advance on behalf of its customers for purposes such as monthly customers employee benefits, social insurance and payroll payments, which will be reimbursed to the Company in the near term. The Company provides an allowance for payments made on behalf of customers when facts and circumstances indicate that the receivable is unlikely to be collected. The movement of allowance for payments made on behalf of customers is analyzed as follows:

	2015 RMB	2016 RMB	2017 RMB
Balance at beginning of period	958	856	459
Additions	1,723	843	9,656
Write-offs	(1,825)	(1,240)	(7,068)
Balance at end of period	856	459	3,047

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

6. PROPERTY AND EQUIPMENT

	2016 RMB	2017 RMB
Land and building	575,443	575,443
Leasehold improvements	30,841	35,709
Electronic equipment	137,236	141,787
Furniture and fixtures	11,837	7,194
Motor vehicles	6,910	7,210
Other assets	48,583	49,095
Less: Accumulated depreciation	(284,309)	(318,593)
Net book value	526,541	497,845

Depreciation expense was RMB49,781, RMB53,754 and RMB53,422 for the years ended December 31, 2015, 2016 and 2017, respectively. Loss due to disposal of fixed assets was RMB109, RMB122 and RMB690 for the years ended December 31, 2015, 2016 and 2017, respectively.

7. GOODWILL

The changes in the carrying amount of goodwill for the years ended December 31, 2016 and 2017 are as follows:

	2016 RMB	2017 RMB
Balance at beginning of period	217,394	217,394
Acquisition of Lagou		804,060
Balance at end of period	217,394	1,021,454

8. INTANGIBLE ASSETS

	2016 RMB	2017 RMB
Computer software	30,521	31,958
Acquired technology	24,272	60,251
Trade names	35,600	95,783
Customer relationships	12,270	12,270
Acquired training and other licenses	3,101	4,151
Less: Accumulated amortization	(32,144)	(42,389)
Net book value	73,620	162,024

Acquired technology consists of software and technology assets. For the year ended December 31, 2016, the Company acquired a mobile application for business card digitalization and contact management that enhances the Company s online services to its users. The purchase price was RMB25,000, including related taxes.

Amortization expense was RMB6,167, RMB9,022 and RMB10,245 for the years ended December 31, 2015, 2016 and 2017, respectively.

The Company will record estimated amortization expenses of RMB23,386, RMB22,092, RMB19,486, RMB18,413 and RMB17,989 for the years ending December 31, 2018, 2019, 2020, 2021 and 2022, respectively.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

9. OTHER PAYABLES AND ACCRUALS

	2016 RMB	2017 RMB
Receipts from customers	469,471	580,794
Payables to customers related to government policy compliance incentives		71,638
Professional service fees	2,271	3,274
Office expenses	5,240	8,636
Payables to employees related to net proceeds from share options exercised	264	137
Accrued interest expense related to convertible senior notes	8,210	7,632
Payable for acquisition	8,450	27,923
Others	4,130	3,407
Total	498,036	703,441

Receipts from customers are associated with the operations of the Company s business process outsourcing services. The Company has received funds in advance from its customers for purposes such as monthly customers employee benefits, social insurance and payroll payments, which will be disbursed by the Company to other parties on behalf of its customers in the near term.

10. TAXATION

Cayman Islands

Under the current laws of the Cayman Islands, the Company and its subsidiaries that are incorporated in the Cayman Islands are not subject to tax on income or capital gain. In addition, upon payments of dividends by those companies to their shareholders, no Cayman Islands withholding tax will be imposed.

British Virgin Islands

Under the current laws of the British Virgin Islands, the Company s subsidiary that is incorporated in the British Virgin Islands is not subject to tax on income or capital gain. In addition, upon payments of dividends by that company to its shareholders, no British Virgin Islands withholding tax will be imposed.

Hong Kong

51net is registered in Hong Kong as a non-Hong Kong company and is subject to Hong Kong profits tax at a rate of 16.5% on its assessable profit.

China

The PRC Enterprise Income Tax Law (EIT Law), which became effective January 1, 2008, applies a uniform enterprise income tax (EIT) rate of 25% to both foreign-invested enterprises (FIEs) and domestic enterprises.

In December 2009, Tech JV was designated by relevant local authorities in Shanghai as a High and New Technology Enterprise under the EIT Law. Tech JV became subject to a preferential tax rate of 15%. Tech JV is entitled to this preferential 15% tax rate as long as it maintains the required qualifications, which is subject to review every three years. The current preferential tax status is valid through 2017, and Tech JV will seek to further renew this status with local tax authorities in 2018.

Beijing Lagou Network Technology Co., Ltd. has also been designated as a High and New Technology Enterprise under the EIT Law. Its current preferential tax status of 15% is valid through 2017, and it will seek to renew this status with local tax authorities in 2018.

The Group s other PRC subsidiaries, VIEs and VIEs subsidiaries are subject to the statutory EIT rate of 25%.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

10. TAXATION (Continued)

The EIT Law also imposes a 10% withholding income tax (WHT) for dividends declared out of the profits earned after January 1, 2008 by a FIE to its immediate holding company outside China. For certain treaty jurisdictions such as Hong Kong which has signed tax treaties with the PRC, the WHT rate is 5%. Since the Company intends to permanently reinvest earnings to further expand its businesses in mainland China, its FIEs do not intend to declare dividends to its immediate foreign holding entities in the foreseeable future. Accordingly, as of December 31, 2017, the Company has not recorded any withholding tax on the retained earnings of its FIEs in China. Cumulative undistributed earnings of the Company s PRC subsidiaries intended to be permanently reinvested totaled RMB4,355,109 and RMB5,324,204, and the amount of the unrecognized deferred tax liability on the permanently reinvested earnings was RMB435,511 and RMB532,420 as of December 31, 2016 and 2017, respectively.

Composition of Income Tax Expense

Income (loss) before income tax expense for the years ended December 31, 2015, 2016 and 2017 were taxed within the following jurisdictions:

	2015 RMB	2016 RMB	2017 RMB
PRC entities	823,007	875,175	1,139,978
Non-PRC entities	(78,909)	(175,289)	(597,722)
Total	744,098	699,886	542,256

The current and deferred portion of income tax expense included in the consolidated statements of operations and comprehensive income for the years ended December 31, 2015, 2016 and 2017 are as follows:

	2015 RMB	2016 RMB	2017 RMB
Current income tax expense			
PRC entities	108,172	120,280	156,706
Non-PRC entities			

Total	108,172	120,280	156,706
Deferred income tax expense			
PRC entities	18,129	14,419	12,787
Non-PRC entities			
Total	18,129	14,419	12,787
Income tax expense			
PRC entities	126,301	134,699	169,493
Non-PRC entities			
Total	126,301	134,699	169,493

Reconciliation of the Differences Between Statutory Tax Rate and the Effective Tax Rate

Reconciliation between the statutory EIT rate in the PRC and the Group s effective tax rate for the years ended December 31, 2015, 2016 and 2017 are as follows:

	2015	2016	2017
EIT statutory rate	25%	25%	25%
Difference in EIT rates of certain subsidiaries	(10)%	(11)%	(20)%
Non-deductibility of expenses incurred outside the PRC	3%	6%	28%
Other permanent differences	(1)%	(1)%	(2)%
Effective EIT rate of the Group	17%	19%	31%

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

10. TAXATION (Continued)

Income tax expense for the years ended December 31, 2015, 2016 and 2017 differs from the amounts computed by applying the EIT rate primarily due to the preferential tax rate enjoyed by Tech JV in the PRC. The aggregate amount and per share effect of the preferential tax rate are as follows:

	2015 RMB	2016 RMB	2017 RMB
		(in thousands, except per share data)	
Aggregate effect	75,864	81,300	107,547
Basic net income per share effect	1.31	1.40	1.79
Diluted net income per share effect	1.21	1.39	1.76

Significant components of deferred tax assets and liabilities as of December 31, 2016 and 2017 are as follows:

	2016 RMB	2017 RMB
Deductible temporary differences related to other payables and accruals	860	1,053
Deductible temporary differences related to provision for doubtful accounts	992	1,265
Deductible temporary differences related to advertising expenses		12,076
Tax loss carryforwards	9,843	50,900
Amount offset by non-current deferred tax liabilities	(8,487)	(12,806)
Total non-current deferred tax assets	3,208	52,488
Less: Valuation allowance	(2,443)	(39,576)
Net non-current deferred tax assets	765	12,912
Total deferred tax assets	765	12,912
Taxable temporary differences related to depreciation period	(5,218)	(6,153)
Taxable temporary differences related to available-for-sale securities	(9,625)	(46,526)
Taxable temporary differences related to government subsidy income	(40,695)	(57,995)
Taxable temporary differences related to trade names, technology and customer relationships	(10,115)	(23,480)
Amount offset by non-current deferred tax assets	8,487	12,806
Total non-current deferred tax liabilities	(57,166)	(121,348)
Total deferred tax liabilities	(57,166)	(121,348)

All deferred tax assets and liabilities within a single tax jurisdiction are offset and presented as a single amount in accordance with ASC 740-10-45-6 Income Taxes Overall Other Presentation Matters. The Group has early adopted ASU 2015-17 prospectively starting from 2016 and classified all deferred tax assets and liabilities as non-current items on its consolidated balance sheet as of December 31, 2016 and 2017.

As of December 31, 2016 and 2017, valuation allowances were provided on the deferred tax assets to the extent that management believed it was more likely than not that such deferred tax assets would not be realized in the foreseeable future. Valuation allowances were also provided because it was more likely than not that the Group will not be able to utilize certain tax loss carryforwards generated by certain subsidiaries or VIEs. As those entities continue to generate tax losses and tax planning strategies are not available to utilize those tax losses in other group companies, management believes it is more likely than not that such losses will not be utilized before they expire. However, certain valuation allowance was reversed in 2015, 2016 and 2017 when certain entities generated sufficient taxable income to utilize the deferred tax assets. If events occur in the future that prevent these entities from realizing some or all of its deferred tax assets, an adjustment to the valuation allowances will be recognized when such events occur. As of December 31, 2017, the Group had net operating loss carryforwards in PRC entities of RMB202,645, which can be carried forward to offset taxable income. The carryforward period for net operating losses under the EIT Law is five years. The net operating loss carryforwards of the Group will expire in varying amounts from 2018 to 2022. Other than the expiration, there are no other limitations or restrictions upon the Group s ability to use these operating loss carryforwards.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

10. TAXATION (Continued)

The following represents a roll-forward of the valuation allowance for each of the years:

	2015 RMB	2016 RMB	2017 RMB
Balance at beginning of period	464	1,851	2,443
Additions	1,443	1,019	37,902
Reversals	(56)	(427)	(769)
Balance at end of period	1,851	2,443	39,576

11. SHARE-BASED COMPENSATION

In April 2009, the Company adopted a share option plan (2009 Option Plan), which provided for the issuance of up to 5,000,000 common shares. The total number of common shares reserved under the 2009 Option Plan was increased to 10,000,000 in December 2011. Issuances from this plan ceased in 2015.

In November 2015, the Company adopted a share incentive plan (2015 Plan). Under the 2015 Plan, share-based awards such as share options, restricted shares, restricted share units, dividend equivalent rights, share appreciation rights and share payments may be granted. The 2015 Plan has a term of ten years. The maximum aggregate number of common shares which may be issued pursuant to all share-based awards under the 2015 Plan is (i) 10,000,000, and (ii) an automatic increase on January 1, 2019, January 1, 2022 and January 1, 2025 by that number of common shares representing 5% of the then total issued and outstanding common shares of the Company on an as-converted fully diluted basis as of December 31 of the respective preceding year.

Under the share option and incentive plans, the directors may, at their discretion, grant share-based awards to any senior executives, directors, employees or consultants of the Group. As of December 31, 2017, the only share-based awards that have been granted under the plans are share options to purchase the Company s common shares. The share options are granted at the fair market value of the common shares at the date of grant, vest over a period of four years and expire six years from the date of grant.

The following table summarizes the Company s share option activity for the year ended December 31, 2017:

	Number of shares		Weighted average exercise price	Weighted average remaining contractual life (years)		Aggregate intrinsic value (thousands)
Outstanding at January 1, 2017	5,794,831	US$	30.58			
Granted	1,279,872	US$	56.68			
Exercised	(2,147,819)	US$	29.04			
Forfeited	(119,902)	US$	32.64			
Outstanding at December 31, 2017	4,806,982	US$	38.17	3.83	US$	109,017
Vested and expected to vest at December 31, 2017	4,560,233	US$	37.86	3.78	US$	104,855
Exercisable at December 31, 2017	2,236,685	US$	30.66	2.65	US$	67,535

The aggregate intrinsic value in the table above represents the difference between the Company s closing stock price on the last trading day in 2017 and the exercise price for in-the-money options.

The total intrinsic value of options exercised for the years ended December 31, 2015, 2016 and 2017 was RMB92,723, RMB83,976 and RMB184,932 (US$28,424), respectively.

As of December 31, 2017, there was RMB215,124 (US$33,064) of unrecognized share-based compensation cost related to non-vested share options. That deferred cost is expected to be recognized over a weighted average vesting period of 3.00 years. To the extent the actual forfeiture rate is different from the original estimate, actual share-based compensation related to these awards may be different from the expectation. For the year ended December 31, 2017, total cash received from the exercise of share options amounted to RMB424,450 (US$65,237).

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

11. SHARE-BASED COMPENSATION (Continued)

A summary of non-vested share option activity for the year ended December 31, 2017 is presented below:

	Number of shares		Weighted average grant-date fair value (per share)
Non-vested at January 1, 2017	2,495,346	US$	10.37
Granted	1,279,872	US$	15.62
Vested	(1,085,019)	US$	10.50
Forfeited	(119,902)	US$	10.55
Non-vested at December 31, 2017	2,570,297	US$	12.86
Expected to vest at December 31, 2017	2,323,548	US$	12.88

There were no capitalized share-based compensation costs for the years ended December 31, 2015, 2016 and 2017. Share-based compensation expense with respect to the share option plans recognized during the years ended December 31, 2015, 2016 and 2017, totaled RMB85,945, RMB86,070 and RMB85,968 (US$13,213), respectively. The total fair value of share options vested during the years ended December 31, 2015, 2016 and 2017 was RMB84,594, RMB79,139 and RMB74,100 (US$11,389), respectively.

Share-Based Compensation of Subsidiary

Lagou has adopted a 2014 Stock Option Plan and a 2016 Stock Option Plan (collectively, the Lagou Stock Option Plans), which permit the granting of stock options and/or stock purchase rights of Lagou to employees, directors and consultants. As of December 31, 2017, the unrecognized share-based compensation expenses related to the Lagou Stock Option Plans were RMB4,088 (US$628). The expenses are expected to be recognized over a weighted-average period of 1.92 years.

12. EMPLOYEE BENEFITS

The full-time employees of the Group s subsidiaries and VIEs that are incorporated in the PRC are entitled to staff welfare benefits including medical care, welfare subsidies, unemployment insurance, pension benefits and housing fund. These companies are required to contribute to these benefits based on certain percentages of the employees salaries in accordance with the relevant regulations and charge the amount contributed to these benefits to the consolidated statements of operations and comprehensive income. The total amounts charged to the consolidated statements of operations and comprehensive income for such employee benefits amounted to RMB169,572, RMB198,272 and RMB230,263 for the years ended December 31, 2015, 2016 and 2017, respectively. The PRC government is responsible for the welfare and medical benefits and ultimate pension liability to these employees.

13. CONVERTIBLE SENIOR NOTES

On April 3, 2014, the Company issued US$172,500 of convertible senior notes due April 15, 2019 (the Notes). The Notes bear interest at a rate of 3.25% per year, payable semiannually in arrears. The interest expense incurred associated with the Notes was RMB34,983, RMB37,298 and RMB37,799 for the years ended December 31, 2015, 2016 and 2017, respectively.

The Notes may be converted to the Company s ADSs based on an initial conversion rate of 11.6976 ADSs per US$1,000 principal amount of the Notes (which represents an initial conversion price of US$85.49 per ADS). The conversion rate is subject to certain anti-dilutive adjustments. Following the change in the ratio of the Company s common shares to ADSs from 2:1 to 1:1 effective August 8, 2014, the initial conversion rate was adjusted to 23.3952 ADSs per US$1,000 principal amount of the Notes (which represents an adjusted initial conversion price of approximately US$42.74 per ADS).

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

13. CONVERTIBLE SENIOR NOTES (Continued)

Holders may convert their Notes on or after October 15, 2018 until the close of business on the second scheduled trading day immediately preceding the maturity date, or at their option prior to the close of business on the business day immediately preceding October 15, 2018 only under the following circumstances: (i) during any calendar quarter commencing after the calendar quarter ending on June 30, 2014 (and only during such calendar quarter), if the last reported sale price of ADSs for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (ii) during the five business day period after any ten consecutive trading day period (the measurement period) in which the trading price (as defined in the indenture agreement) per US$1,000 principal amount of the Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the ADSs and the conversion rate on each such trading day; (iii) if the Company call the Notes for redemption; or (iv) upon the occurrence of specified corporate events (as defined in the indenture agreement). Upon conversion, the Company will pay or deliver, as the case may be, cash, ADSs, or a combination of cash and ADSs, at its election.

Holders had the right to require the Company to repurchase for cash all or part of the Notes on April 15, 2017 at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but not including, the repurchase date. The Company did not receive any repurchase requests from holders on April 15, 2017, and the Notes were reclassified from current to non-current on the consolidated balance sheet following this date.

If the Company undergoes a fundamental change (as defined in the indenture agreement), holders may require the Company to repurchase for cash all or part of the Notes at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but not including, the fundamental change repurchase date. The Company does not have the option to redeem the Notes prior to their maturity, except in the event of tax redemption.

The Notes are senior unsecured obligations. The Notes (i) rank senior in right of payment to any of the Company s indebtedness that is expressly subordinated in right of payment to the Notes; (ii) rank equally in right of payment with any unsecured indebtedness that is not so subordinated; (iii) be effectively junior in right of payment to any secured indebtedness to the extent of the value of the assets securing such indebtedness; and (iv) be structurally subordinated to all indebtedness and other liabilities (including trade payables) of the Company s subsidiaries and consolidated VIEs.

The Group s functional currency is the RMB, and the Notes are denominated in US$. As a result, the conversion feature of the Notes is indexed to the Company s stock as well as the RMB and US$ exchange rate. Therefore, it is considered an embedded derivative which is required to be bifurcated from the host instrument in accordance with ASC 815 Derivatives and Hedging.

Under ASC 815-15-25, if an entity has a hybrid financial instrument that would require bifurcation of embedded derivatives, the entity may irrevocably elect to initially and subsequently measure a hybrid financial instrument in its entirety at fair value with changes in fair value recognized in earnings. The Company has elected to measure the Notes in their entirety at fair value with changes in fair value recognized as non-operating income or loss at each balance sheet date in accordance with ASC 815-15-25. Furthermore, the fair value of the Notes is translated into RMB, the Group s functional currency, at each balance sheet date with the difference being reported as foreign currency translation gain or loss. In addition, issuance costs of RMB33,093 associated with the Notes offering have been fully expensed as incurred in the year ended December 31, 2014 in accordance with ASC 825-10-25-3, which states that upfront costs and fees related to items for which the fair value option is elected shall be recognized in the consolidated statements of operations and comprehensive as incurred and not deferred.

As of December 31, 2017, the estimated fair value of the Notes amounted to RMB1,667,967. The Company recorded a foreign currency translation loss of RMB64,838, a loss of RMB79,393 and a gain of RMB85,917 for the years ended December 31, 2015, 2016 and 2017, respectively, associated with the Notes. The change in fair value of the Notes was a gain of RMB67,168, a loss of RMB69,439 and a loss of RMB496,175 for the years ended December 31, 2015, 2016 and 2017, respectively. See Note 2(t).

As of December 31, 2017, none of the Notes had been converted yet.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

13. CONVERTIBLE SENIOR NOTES (Continued)

Zero-Strike Call Options

On April 3, 2014 and in connection with the issuance of the Notes, the Company used approximately US$50,000 of the net proceeds from the offering to enter into zero-strike call option transactions (Call Options), covering 1,462,204 ADSs, with affiliates of the initial purchasers of the Notes (Dealers). The Call Options are intended to facilitate privately negotiated transactions by which investors in the Notes are able to hedge their investment. The Call Options expire soon after the maturity date of the Notes or when the Dealers request early settlement. The Company will receive the fixed number of ADSs determined at the commencement date of the transaction, which is based on the market price per ADS at the commencement date. 357,200 ADSs were early settled in 2017. There was no early settlement in 2015 and 2016.

The economic substance of the Call Options is the same as a traditional forward repurchase contract. Because the Call Options permitted net cash settlement prior to shareholder approval of an increase in the Company s share repurchase program, they were classified as a derivative instrument measured initially and subsequently at fair value with changes in fair value recorded in earnings. The Company accounted for the Call Options as a free-standing derivative asset on its consolidated balance sheet when the Call Options were entered into in April 2014. The derivative asset was initially recorded at its fair value of US$50,000 on the commencement date which represented the amount of cash transferred to the Dealers. The derivative asset was subsequently recorded at fair value with the change in fair value through June 20, 2014, the date on which shareholder approval was received, recorded in the consolidated statements of operations and comprehensive income in the amount of RMB24,874. Upon shareholder approval of an increase to the Company s share repurchase program in June 2014, the asset was reclassified and recorded as a reduction to equity to reflect the Company s repurchase of its own shares.

A prepaid forward contract is considered a form of a stock borrowing facility, and economically, the contract is construed as a share lending arrangement between the Company and the Dealers. Therefore, the accounting for a share lending arrangement was applied by analogy in accordance with ASC 470-20-25-20A. In the year ended December 31, 2014, the Company recorded a debt issuance cost of RMB14,429 with the offset to additional paid-in capital for the fair value of the arrangement. Given that the Company has elected to fair value the Notes entirely, the debt issuance costs in connection with the Notes were recognized in earnings as incurred in the consolidated statements of operations and comprehensive income in accordance with ASC 825-10-25-3. See Note 2(t).

14. REPURCHASE OF SHARES

On June 20, 2014, the Company s shareholders resolved to increase the size of a share repurchase program originally approved by shareholders on September 30, 2008 from US$25,000 to US$75,000. The share repurchases may be made on the open market, in block trades or otherwise and is subject to the Company s memorandum and articles of association, the relevant rules under United States securities laws and regulations, and the relevant stock exchange rules. The program does not have an expiration date and may be suspended or discontinued at any time.

For the year ended December 31, 2015, the Company repurchased 898,950 ADSs for a total consideration of RMB157,272, including transaction fees, from the open market. The Company did not repurchase ADSs in the open market in 2016 and 2017. In addition, the Company received 357,200 ADSs from the early settlement of some shares related to the zero-strike call options in the year ended December 31, 2017. All of the shares repurchased and received from early settlement were retired. See Note 2(v).

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

15. EARNINGS PER SHARE

Basic earnings per share and diluted earnings per share have been calculated for the years ended December 31, 2015, 2016 and 2017 as follows:

	2015 RMB	2016 RMB	2017 RMB
	(in thousands, except share and per share data)		
Numerator:			
Net income attributable to 51job, Inc.	618,057	565,978	371,889
Eliminate the dilutive effect of interest expense, change in fair value and foreign exchange translation related to convertible senior notes	32,653		
Numerator for diluted earnings per share	650,710	565,978	371,889
Denominator:			
Denominator for basic earnings per share weighted average common shares outstanding	57,714,850	58,132,976	60,087,306
Dilutive effect of convertible senior notes	4,035,672		
Dilutive effect of share options	748,129	341,092	1,063,107
Denominator for diluted earnings per share	62,498,651	58,474,068	61,150,413
Basic earnings per share	10.71	9.74	6.19
Diluted earnings per share	10.41	9.68	6.08

The convertible senior notes were not included in the calculation of diluted earnings per share in 2016 and 2017 because their inclusion would have been anti-dilutive.

The Company excluded outstanding share options of 3,312,749 in 2015, 3,881,628 in 2016 and 1,176,660 in 2017 from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

The Company excluded common shares underlying the zero-strike call option contracts from both the basic and diluted earnings per share calculation as they are considered as deemed repurchased for the purpose of calculating both basic and diluted earnings per share.

16. RECURRING CHANGE IN FAIR VALUE

The following table provides information about the reconciliation of the Level 3 fair value measurements of available-for-sale investments using significant unobservable inputs for the periods indicated:

	RMB
Balance at January 1, 2016	
Initial recognition	126,716
Unrealized gain	38,501
Balance at December 31, 2016	165,217
Unrealized gain	147,602
Balance at December 31, 2017	312,819

The unrealized gain on available-for-sale investments of RMB28,876 and RMB110,702, representing the unrealized fair value gain netting relevant income tax of RMB9,625 and RMB36,900, was recognized in other comprehensive income for the years ended December 31, 2016 and 2017, respectively.

In determining the fair value, the Group utilizes an income approach of a discounted cash flow model with unobservable inputs including future cash flows, a terminal growth rate of 3%, a discount rate of 21% and a risk-free rate of 3.82%. The determination of the fair value was assisted by an independent appraisal, based on estimates, judgments and information of other comparable companies.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

17. COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments

The Group has entered into non-cancelable agreements with initial or remaining terms in excess of one year for the rental and property management of office premises and for the lease of office equipment. Future minimum payments with respect to these agreements for the twelve months ending December 31 of the coming years are as follows:

	Office Premises RMB	**Office equipment RMB**	**Total RMB**
2018	50,363	14,202	64,565
2019	28,416	544	28,960
2020	18,205	199	18,404
2021	9,861	20	9,881
2022 and thereafter	3,955		3,955
	110,800	14,965	125,765

Rental expenses for the years ended December 31, 2015, 2016 and 2017 were RMB48,760, RMB50,946 and RMB53,433, respectively.

Contractual Purchase Obligations

The Group s contractual purchase obligations consist of agreements to purchase advertising services from media companies and to purchase electronic equipment. Future minimum payments with respect to these agreements for the twelve months ending December 31 of the coming year are as follows:

Total

	Advertising Services RMB	Electronic equipment RMB	RMB
2018	7,483	4,050	11,533

Contingencies

As of the filing date of this annual report on Form 20-F, the Group is not currently a party to, nor is aware of, any legal proceeding, investigation or claim which is likely to have a material adverse effect on the Group s business, financial condition, results of operations and cash flows.

Tech JV obtained an advertising license in May 2000, when Tech JV was a 98% foreign owned entity, and a license to conduct human resource services in September 2002, when Tech JV was a 99% foreign owned entity. During the period from the date Tech JV acquired these licenses to the Group s restructuring in May 2004, Tech JV and its licensed PRC subsidiaries conducted all of the advertising and human resource related services. Following the acquisition of these licenses and commencing these operations, the PRC government enacted laws limiting foreign ownership in entities conducting advertising and human resource related services. The PRC government has permitted 100% foreign ownership of advertising businesses since December 2005. For the foreign ownership of human resource services companies, the limitation was 70% for Hong Kong service providers and Macau service providers since June 2005 and for human resource services companies registered in several locations in the PRC, such as Pudong New District, Shanghai since June 2006. Starting from January 2008, the PRC government no longer implemented any foreign ownership percentage limitation for Hong Kong service providers and Macau service providers.

Table of Contents

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

17. COMMITMENTS AND CONTINGENCIES (Continued)

Prior to the restructuring in May 2004, the ownership percentage of Tech JV was above the maximum foreign ownership permitted for an entity conducting advertising and human resource operations. The PRC government has not published an official ruling with respect to the status of foreign ownership arrangements that were established prior to the enactment of these limitations and the Group has not received any waiver from the PRC government with respect to this past non-compliance. The PRC government may determine that the Group s ownership structure was inconsistent with or insufficient for the proper operation of the Group s businesses, or that the Group s business licenses or other approvals were not properly issued or not sufficient. In the opinion of management, the likelihood of loss with respect to the Group s past ownership structure is remote.

18. REDEEMABLE NON-CONTROLLING INTERESTS

In December 2017, the Company acquired an approximately 66% equity interest in Lagou on a fully diluted basis. Lagou has been consolidated into the Group s financial statements as of December 31, 2017. As Lagou has shares that could be redeemed by minority shareholders upon the occurrence of certain events that are not solely within the control of the Company, these preferred shares are accounted for as redeemable non-controlling interests in mezzanine equity.

The redeemable non-controlling interests for the year ended December 31, 2017 are summarized below:

	RMB
Balance at January 1, 2017	
Addition	228,230
Balance at December 31, 2017	228,230

19. CERTAIN RISKS AND CONCENTRATION

Concentration of Credit Risk

Financial instruments that potentially subject the Group to significant concentrations of credit risk consist primarily of cash, restricted cash, short-term investments and receivables. As of December 31, 2016 and 2017, the Group s cash, restricted cash and short-term investments were held in major financial institutions located in the PRC, Hong Kong and the United States which management believes are of high credit quality. As of December 31, 2017, the Company had approximately RMB6,314,177 (US$970,471) in cash, time deposits and investment products, which constitute about 89% of total cash, restricted cash and short-term investments, held at reputable financial institutions in the PRC. The Company believes that it is not exposed to unusual risks as these PRC financial institutions have high credit quality. However, in the event of bankruptcy of a financial institution in which the Company has deposits or investments, it may be unlikely to claim its deposits or investments back in full.

Receivables are typically unsecured and denominated in RMB, and are derived from revenues earned from operations or from payments made on behalf of certain customers arising in the PRC. Management believes credit risk on receivables is moderate due to the diversity of its services and customers.

No individual customer accounted for more than 10% of net revenues during the years ended December 31, 2015, 2016 and 2017. No individual customer accounted for more than 10% of accounts receivable as of December 31, 2016 and 2017.

Currency Risk

The Group s sales and purchase and expense transactions are generally denominated in RMB and a significant portion of the Group s liabilities are denominated in RMB. RMB is not freely convertible into foreign currencies.

In the PRC, foreign exchange transactions are required by law to be transacted only by authorized financial institutions at exchange rates set by the People s Bank of China. In addition, the Group s cash and convertible senior notes denominated in US$ subject the Group to risks associated with changes in the exchange rate of RMB against US$ and may affect the Group s results of operations going forward.

51JOB, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2015, 2016 AND 2017

(Amounts expressed in thousands of RMB and US$, except share and per share data)

19. CERTAIN RISKS AND CONCENTRATION (Continued)

PRC Regulatory Risk

The Group is subject to regulatory risks, which include the interpretation of current laws, the legality of its corporate structure and the scope of its operations in the PRC, which may result in limitations on the Group s ability to conduct business in the PRC.

The Group conducts some of its operations in the PRC through VIEs and consolidates them pursuant to a series of contractual arrangements. If the contractual arrangements establishing the VIE structure are found to be in violation of any existing or future PRC laws, rules or regulations, the Group may be subject to penalties, which may include but not be limited to, the cancellation or revocation of the Group s business and operating licenses, being required to restructure the Group s operations or discontinue the Group s operating activities. The imposition of any of these or other penalties may result in a material and adverse effect on the Group s ability to conduct its operations. In such case, the Group may lose its rights to direct the activities of and receive economic benefits from its VIEs, which may result in deconsolidation of the VIEs.

In addition, any change in interpretation of current laws or any future laws affecting the determination of whether a VIE is a domestic or foreign-invested company may materially impact the viability of the Group s current corporate structure, corporate governance and business operations in many aspects. For example, the draft Foreign Investment Law published by the PRC Ministry of Commerce (MOFCOM) on January 19, 2015, if enacted as proposed, may cause the VIEs to be deemed as entities with foreign investment, and as a result, the Group s VIEs and subsidiaries in which these VIEs have direct or indirect equity ownership could be subject to the current restrictions on foreign investment in an industry within the catalogue of special management measures (the negative list) to be issued by the PRC State Council. If the enacted version of the Foreign Investment Law and the final negative list mandate further actions, such as MOFCOM market entry clearance or certain restructuring of the corporate structure and operations to be completed by companies with existing VIE structure like the Group s, the Group will face substantial uncertainties as to whether these actions can be timely completed, or at all. As a result, the Group s business, operating results and financial condition may be adversely affected.

20. RELATED PARTY TRANSACTION AND BALANCES

The Company has entered into royalty agreements with Recruit Management Solutions Co., Ltd. (RMS) and Recruit Career Co., Ltd. (RCC), which are wholly owned subsidiaries of Recruit Holdings Co., Ltd. (Recruit), for the use of training and online assessment materials. Recruit is a shareholder of the Company. The royalty fees charged by RMS were RMB133, RMB152 and RMB270 during the years ended December 31, 2015, 2016 and 2017, respectively. The royalty fees charged by RCC were RMB169, RMB60 and RMB20 during the years ended December 31, 2015, 2016 and 2017, respectively. As of December 31, 2016 and 2017, the royalty payables due to RMS were RMB74 and RMB68, respectively. As of December 31, 2016 and 2017, the royalty payables due to RCC were RMB8 and RMB0.5, respectively.

21. SUBSEQUENT EVENT

In March 2018, the Company entered into an agreement to acquire assets, including an online audio/video program transmission license, of an online training services company in the PRC for approximately RMB89,796.