Carbonite Inc
Form 10-Q
August 05, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission file number: 001-35264

CARBONITE, INC.
(Exact name of registrant as specified in its charter)

Delaware	33-1111329
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

Two Avenue de Lafayette, Boston, Massachusetts 02111
(Address of principal executive offices, including ZIP code)
(617) 587-1100
(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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
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. (Check one):

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of July 31, 2015, there were 27,448,353 shares of the registrant’s Common Stock, par value $0.01 per share, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
Carbonite, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2015	December 31, 2014
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 60,929	$ 46,084
Marketable securities	3,990	15,031
Trade accounts receivable, less allowances for doubtful accounts of $187 and $156	3,396	2,412
Prepaid expenses and other current assets	4,217	5,224
Restricted cash	221	828
Total current assets	72,753	69,579
Property and equipment, net	25,101	25,944
Other assets	1,677	2,181
Acquired intangible assets, net	8,795	10,322
Goodwill	22,759	23,728
Total assets	$ 131,085	$ 131,754
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,963	$ 7,346
Accrued expenses	10,771	10,506
Current portion of deferred revenue	79,827	75,494
Total current liabilities	98,561	93,346
Deferred revenue, net of current portion	16,988	15,930
Other long-term liabilities	7,637	7,940
Total liabilities	123,186	117,216
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, $0.01 par value; 6,000,000 shares authorized; no shares issued	—	—
Common stock, $0.01 par value; 45,000,000 shares authorized at June 30, 2015 and December 31, 2014; 27,436,121 and 27,207,723 shares issued at June 30, 2015 and December 31, 2014, respectively	274	272
Additional paid-in capital	159,399	152,920
Treasury stock, at cost (276,709 and 2,009 shares as of June 30, 2015 and December 31, 2014, respectively)	(3,012)	(22)
Accumulated other comprehensive income	1,616	696
Accumulated deficit	(150,378)	(139,328)
Total stockholders' equity	7,899	14,538
Total liabilities and stockholders' equity	$ 131,085	$ 131,754

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

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Carbonite, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands, except share and per share amounts)			
Revenue	$33,972	$30,295	$66,998	$59,433
Cost of revenue	9,800	9,721	19,814	18,982
Gross profit	24,172	20,574	47,184	40,451
Operating expenses:				
Research and development	7,448	6,153	14,377	11,575
General and administrative	7,624	3,831	15,200	7,351
Sales and marketing	13,570	13,132	27,951	25,005
Restructuring charges	6	5	125	8
Total operating expenses	28,648	23,121	57,653	43,939
Loss from operations	(4,476)	(2,547)	(10,469)	(3,488)
Interest and other income (expense), net	59	21	26	(10)
Loss before income taxes	(4,417)	(2,526)	(10,443)	(3,498)
Provision for income taxes	403	10	607	20
Net loss	$(4,820)	$(2,536)	$(11,050)	$(3,518)
Basic and diluted net loss per share	$(0.18)	$(0.09)	$(0.41)	$(0.13)
Weighted-average number of common shares used in computing basic and diluted net loss per share	27,217,528	26,768,786	27,226,067	26,676,485

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

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Carbonite, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Net loss	$(4,820)	$(2,536)	$(11,050)	$(3,518)
Other comprehensive (loss) income:				
Net unrealized gain (loss) on marketable securities	1	(6)	8	(8)
Foreign currency translation adjustments	(427)	20	912	(5)
Total other comprehensive (loss) income	(426)	14	920	(13)
Total comprehensive loss	$(5,246)	$(2,522)	$(10,130)	$(3,531)

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

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Carbonite, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
	2015	2014
	(in thousands)	
Operating activities		
Net loss	$(11,050)	$(3,518)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,838	6,296
Gain on disposal of equipment	(33)	—
Accretion of discount on marketable securities	(9)	(12)
Stock-based compensation expense	4,873	2,854
Provision for reserves on accounts receivable	31	53
Other non-cash items, net	58	—
Changes in assets and liabilities:		
Accounts receivable	(1,076)	(425)
Prepaid expenses and other current assets	338	(507)
Other assets	530	113
Accounts payable	418	759
Accrued expenses	124	481
Other long-term liabilities	(60)	835
Deferred revenue	5,565	3,671
Net cash provided by operating activities	6,547	10,600
Investing activities		
Purchases of property and equipment	(4,906)	(5,040)
Proceeds from sale of property and equipment	33	—
Proceeds from maturities of marketable securities and derivatives	14,442	6,000
Purchases of marketable securities and derivatives	(436)	(6,000)
Increase in restricted cash	693	—
Net cash provided by (used in) investing activities	9,826	(5,040)
Financing activities		
Proceeds from exercise of stock options	1,622	1,408
Repurchase of common stock	(2,990)	—
Net cash (used in) provided by financing activities	(1,368)	1,408
Effect of currency exchange rate changes on cash	(160)	(4)
Net increase in cash and cash equivalents	14,845	6,964
Cash and cash equivalents, beginning of period	46,084	50,392
Cash and cash equivalents, end of period	$60,929	$57,356
Supplemental disclosure of cash flow information		
Cash paid for income taxes	405	—
Non-cash investing activities		
Acquisition of property and equipment included in accounts payable and accrued expenses	192	(684)

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

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Carbonite, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Nature of Business

Carbonite, Inc. (the “Company”) was incorporated in the State of Delaware on February 10, 2005 and is a provider of cloud and hybrid business continuity solutions. The Company’s solutions provide powerful features packaged in a cost-effective, simple and secure manner and are designed to address the specific needs of small and medium-sized businesses (SMBs) and individuals.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions between the Company and its subsidiaries have been eliminated in consolidation.

The accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), the instructions to Form 10-Q, and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and the notes thereto, included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as filed with the SEC on March 10, 2015, as amended on Form 10-K/A, as filed with the SEC on May 1, 2015.

In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company’s financial position for the periods presented. The results for the periods presented are not necessarily indicative of future results.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results may differ from management’s estimates if past experience or other assumptions do not turn out to be substantially accurate, even if such assumptions are reasonable when made.

Translation of Foreign Currencies

The functional currency of the Company’s foreign subsidiaries is generally the local currency in which they operate. The Company translates foreign subsidiaries' assets and liabilities at the exchange rates in effect at period-end and revenues and expenses at the average exchange rates in effect during the period. Gains and losses from foreign currency translation are recorded as a component of other comprehensive loss.

Foreign currency transaction gains and losses are included in "interest and other income (expense), net" in our consolidated statements of operations, net of losses and gains from any related derivative financial instruments.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk primarily consist of cash and cash equivalents, marketable securities, derivatives, and accounts receivable. The Company maintains its cash and cash equivalents, marketable securities, and derivatives with high-quality financial institutions and, consequently, the Company believes that such funds are subject to minimal credit risk. Cash equivalents and marketable securities consist of investment grade debt securities or money market funds investing in such securities.

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The Company sells its services primarily to small and medium-sized businesses and individuals. Payment for the majority of the Company’s sales occurs via credit card. The Company regularly reviews its accounts receivable related to customers billed on traditional credit terms and provides an allowance for expected credit losses. Due to these factors, no additional credit risk beyond amounts provided for collection losses is believed by management to be probable in the Company’s accounts receivable. At June 30, 2015 and December 31, 2014, no customer represented 10% or more of the Company’s accounts receivable balance and no customer represented 10% or more of the Company’s revenue for the periods presented.

Revenue Recognition

The Company derives revenue from Software-as-a-Service ("SaaS") offerings, software license agreements and post-contract customer support ("PCS"). Generally, the Company recognizes revenue when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable and (iv) collectibility is probable. Our revenue recognition policies for these revenue streams are discussed below.

Software-as-a-Service Arrangements

The Company derives the majority of its revenue from cloud and hybrid business continuity solutions subscription services. These services are standalone independent service solutions, which are generally contracted for a one- to three-year term. Subscription arrangements include access to use the Company’s services via the internet. The Company recognizes revenue in accordance with Accounting Standards Codification (“ASC”) 605-10, Overall Revenue Recognition. Subscription revenue is recognized ratably on a daily basis upon activation of service over the subscription period, when persuasive evidence of an arrangement with a customer exists, the subscription period has been activated, the price is fixed or determinable, and collection is reasonably assured. Deferred revenues represent payments received from customers for subscription services prior to recognizing the revenue related to those payments.

Software and Software-related Arrangements

The Company derives the remainder of its revenue from software arrangements, which often contain multiple revenue elements, such as software licenses and PCS. For multiple element software arrangements which qualify for separate element treatment, revenue is recognized for each element when each of the four basic criteria is met, which, excluding PCS, is typically upon delivery. Revenue for PCS agreements is recognized ratably over the term of the agreement, which is generally one year. Revenue is allocated to each element, excluding the software license, based on vendor-specific objective evidence ("VSOE"). VSOE is limited to the price charged when the element is sold separately or, for an element not yet being sold separately, the price established by management having the relevant authority. The Company does not have VSOE for our software licenses since they are seldom sold separately. Accordingly, revenue is allocated to the software license using the residual value method. Under the residual value method, revenue equal to VSOE of each undelivered element is initially deferred and any remaining arrangement fee is then allocated to the software license.

Cash Equivalents and Marketable Securities

The Company considers all highly liquid investments purchased with an original purchase maturity of 90 days or less to be the equivalent of cash for the purpose of balance sheet and statement of cash flows presentation.

Marketable securities consist of time deposits and U.S. treasury securities with initial maturities of more than 90 days. Short-term investments in marketable securities are classified as available-for-sale and are recorded at fair value with unrealized gains and losses (excluding other-than-temporary impairments) reported as a separate component of accumulated other comprehensive loss. Realized gains and losses and declines in value judged to be other-than-temporary are included in income based on the specific identification method. Fair value is determined based on quoted market prices. At June 30, 2015 and December 31, 2014, the Company’s marketable securities have remaining maturities within two years and have a total cost basis of $4.0 million and $15.0 million, respectively. The Company reviews its investments for other-than-temporary impairment whenever evidence indicates that an investment’s carrying amount is not recoverable within a reasonable period of time.

Business Combinations

In accordance with ASC 805, Business Combinations ("ASC Topic 805"), the Company recognizes tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. Determining these fair values requires management to make significant estimates and assumptions, especially with respect to intangible assets.

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The fair value of identifiable intangible assets is based on detailed valuations that use information and assumptions provided by management, which reflect management's best estimates of inputs and assumptions that a market participant would use. The Company's identifiable intangible assets consist of developed technology, customer relationships, tradenames, and non-compete agreements. Developed technology consists of products that have reached technological feasibility, and tradenames represent both acquired company and product names. Customer relationships represent the underlying relationships and agreements with customers of the acquired company's installed base. Non-compete agreements represent the protection against the loss of business and resultant cash flows from direct competition.

Goodwill and Acquired Intangible Assets

The Company records goodwill when consideration paid in a business acquisition exceeds the value of the net assets acquired. The Company's estimates of fair value are based upon assumptions believed to be reasonable at that time but that are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events or circumstances may occur, which may affect the accuracy or validity of such assumptions, estimates or actual results.

Goodwill is not amortized, but rather is tested for impairment annually or more frequently at the reporting unit level if facts and circumstances warrant a review. The Company has determined that there is a single reporting unit for the purpose of conducting this goodwill impairment assessment. For purposes of assessing potential impairment, the Company estimates the fair value of the reporting unit (based on the Company's market capitalization) and compares this amount to the carrying value of the reporting unit (as reflected by the Company's total stockholders' equity). If the Company determines that the carrying value of the reporting unit exceeds its fair value, an impairment charge would be required. The Company's annual goodwill impairment test is at November 30th of each year.

Intangible assets acquired in a business combination are recorded at their estimated fair values at the date of acquisition. The Company amortizes acquired intangible assets over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis. The Company reviews its intangible assets with definite lives for impairment when events or changes in circumstances indicate that the related carrying amount may not be recoverable.

Internal-use Software and Website Development

The Company accounts for its software and website development costs in accordance with the guidance in ASC 350-40, Internal Use Software and ASC 350-50, Website Development Costs. The costs incurred in the preliminary stages of development are expensed as incurred. Once an application has reached the development stage, internal and external costs, if direct and incremental, are capitalized until the application is substantially complete and ready for its intended use, at which point the costs are amortized over the estimated useful life of the software. As of June 30, 2015 and December 31, 2014, approximately $1.1 million and $1.0 million of costs associated with internal-use software and website development costs, respectively, were capitalized on the Company's consolidated balance sheets. For the three-month period ended June 30, 2015, the Company recorded $0.1 million of amortization expense related to capitalized internal-use software and website development costs. There was no amortization expense of capitalized amounts recorded for the three-month period ended June 30, 2014.

Income Taxes

The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization.

The Company accounts for uncertain tax positions recognized in the consolidated financial statements by prescribing a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Segment Information

Operating segments are defined as components of an enterprise engaging in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment. The

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Company does not disclose geographic information for revenue and long-lived assets, excluding deferred tax assets, goodwill and intangible assets. Revenue and long-lived assets, excluding deferred tax assets, goodwill and intangible assets, located outside the United States do not exceed 10% of total revenue and total assets.

Accounting for Stock-Based Compensation

The Company recognizes stock-based compensation as an expense in the financial statements based on the estimated fair value for stock-based awards granted over the requisite service periods for the individual awards, which generally equals the vesting periods. The Company uses the straight-line amortization method for recognizing stock-based compensation expense. The Company estimates the fair value of stock options on the date of grant using the Black-Scholes option-pricing model and the fair value of equity awards with market based vesting provisions on the date of grant using a lattice model with a Monte-Carlo simulation. These models require the use of highly subjective estimates and assumptions, including expected stock price volatility, expected term of an award, risk-free interest rate, and expected dividend yield. The grant date fair value of restricted stock units granted is based on the fair value of the underlying common stock on the date of grant.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-9, Revenue from Contacts with Customers ("ASU 2014-9"), updated guidance and disclosure requirements for recognizing revenue. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The revenue standard is based on the principle that revenue should be recognized 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 guidance will be effective for the Company on January 1, 2018, with early adoption permitted, but not earlier than January 1, 2017. The guidance may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial adoption. The Company is currently assessing the potential impact of the adoption of ASU 2014-9 on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements — Going Concern: Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). The standard requires that the Company evaluates, at each interim and annual reporting period, whether there are conditions or events that raise substantial doubt about its ability to continue as a going concern within one year after the date the financial statements are issued, and provide related disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter, and early adoption is permitted. The Company does not expect to early adopt ASU 2014-15, which will be effective for its fiscal year ending December 31, 2016. The Company does not believe the standard will have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software: Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). The standard clarifies the circumstances under which a cloud computing customer would account for the arrangement as a license of internal-use software under ASC 350-40. ASU 2015-05 is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015, and early adoption is permitted. The Company does not expect to early adopt ASU 2015-05, which will be effective for its fiscal year ending December 31, 2016. The Company does not believe the standard will have a material impact on its consolidated financial statements.

3. Net Loss per Share

The Company calculates basic and diluted net loss per share of common stock by dividing the net loss by the weighted average number of unrestricted common shares outstanding for the period. The following potentially dilutive common stock equivalents have been excluded from the computation of diluted weighted-average shares outstanding as of June 30, 2015 and 2014 as they would be anti-dilutive due to the Company's net losses (in thousands):

	As of June 30,	
	2015	2014
Options to purchase common stock (1)	3,436	3,384
Restricted stock units (2)	1,299	437

Total	4,735	3,821

(1) Includes 250,000 options with market based vesting conditions granted to the Company's chief executive officer in December 2014.

(2) Includes 100,000 equity awards with market based vesting conditions granted to the Company's chief financial officer in June 2015.

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4. Fair Value of Financial Instruments

Derivative Instruments

Non-designated Foreign Currency Contracts

The Company uses foreign currency forward contracts as part of our strategy to manage exposure related to Euro denominated intercompany monetary assets and liabilities. The Company has not designated these forward contracts as hedging instruments pursuant to ASC 815, Derivatives and Hedging. Accordingly, the Company recorded the fair value of these contracts at the end of each reporting period in our consolidated balance sheet, with changes in the fair value recorded in earnings as "interest and other income (expense), net" in our consolidated statement of operations. Cash flows from the settlement of these non-designated foreign currency contracts are reported in cash flows from investing activities. These currency forward contracts are entered into for periods consistent with currency transaction exposures, generally less than one year. At June 30, 2015 and December 31, 2014, the Company had outstanding contracts with a total notional value of $28.4 million and $30.6 million, respectively.

The following table provides a quantitative summary of the fair value of derivative instruments not designated as hedging instruments as of June 30, 2015 and December 31, 2014 (in thousands):

Description	Balance Sheet Classification	Fair Value June 30, 2015	December 31, 2014
Non-Designated Hedging Instruments			
Foreign currency contracts	Prepaid expenses and other current assets	$2	$558
Total derivative instruments		$2	$558

The following table summarizes the (losses) gains related to derivative instruments not designated as hedging instruments for the three and six months ended June 30, 2015 and 2014 (in thousands):

		Three Months Ended June 30,		Six Months Ended June 30,	
	Location in Statement of Operations	2015	2014	2015	2014
Foreign currency contracts	Interest and other income (expense), net	$(991)	$—	$2,402	$—

Other Fair Value Measurements

The Company applies the guidance in ASC 820, Fair Value Measurements and Disclosures, (“ASC Topic 820”), which provides that fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC Topic 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3: Unobservable inputs are used when little or no market data is available, which requires the Company to develop its own assumptions about how market participants would value the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible in its assessment of fair value.

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The Company’s assets and liabilities that are measured at fair value on a recurring basis, by level, within the fair value hierarchy are summarized as follows (in thousands):

	June 30, 2015				December 31, 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents—money market funds	$26,707	$—	$—	$26,707	$15,643	$—	$—	$15,643
Marketable securities—U.S. treasury securities and time deposits	—	3,990	—	3,990	—	15,031	—	15,031
Foreign currency exchange contracts	—	2	—	2	—	558	—	558
Total	$26,707	$3,992	$—	$30,699	$15,643	$15,589	$—	$31,232

The Company’s investments in money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. Our marketable securities and foreign currency exchange contracts are classified as Level 2 within the fair value hierarchy as they are valued using professional pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets.

5. Goodwill and Acquired Intangible Assets

As of June 30, 2015 and December 31, 2014, the carrying amount of goodwill was $22.8 million and $23.7 million, respectively. The following is a rollforward of our goodwill balance (in thousands):

	Goodwill	
Balance as of December 31, 2014	$23,728	
Effect of foreign exchange rates	(969	)
Balance as of June 30, 2015	$22,759	

Goodwill is not amortized. The Company reviews goodwill for impairment at least annually in the fourth quarter, or on an interim basis if an event or circumstance occurs indicating the potential for impairment. To date, the Company has had no impairments of goodwill.

Purchased intangible assets consist of the following (in thousands):

		June 30, 2015			December 31, 2014		
	Weighted-Average Estimated Useful Life (in years)	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Developed technology	6.4	$7,880	$1,827	$6,053	$8,303	$1,200	$7,103
Customer relationships	7.2	3,028	912	2,116	3,153	695	2,458
Tradenames	7.1	734	161	573	763	108	655
Non-compete agreements	3.8	380	327	53	380	274	106
		$12,022	$3,227	$8,795	$12,599	$2,277	$10,322

The Company recorded amortization expense of $0.5 million and $0.2 million for the three-month periods ended June 30, 2015 and June 30, 2014, respectively, and $1.0 million and $0.5 million for the six-month periods ended June 30, 2015 and June 30, 2014, respectively. Amortization relating to developed technology is recorded within cost of revenue, amortization of customer relationships is recorded within sales and marketing expenses, and amortization of trade names and non-compete agreements is recorded within general and administrative expenses.

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Future estimated amortization expense of acquired intangibles as of June 30, 2015 is as follows (in thousands):

Remainder of 2015	$932
2016	1,661
2017	1,536
2018	1,516
2019	1,473
Thereafter	1,677
	$8,795

6. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	June 30, 2015	December 31, 2014
Accrued media spend	$1,346	$1,827
Accrued compensation	3,315	2,288
Accrued restructuring	167	325
Accrued tax liabilities	2,381	2,394
Accrued consulting and professional fees	1,640	1,579
Accrued other expenses	1,922	2,093
Total accrued expenses	$10,771	$10,506

7. Stockholders' Equity

Share Repurchase Program

On May 11, 2015, the Company's Board of Directors authorized a $20.0 million share repurchase program, effective from May 15, 2015 through May 15, 2018. Share repurchases are made from time-to-time in the open market, in privately negotiated transactions or otherwise, in accordance with applicable securities laws and regulations. The timing and amount of any share repurchases are determined by the Company's management based on an evaluation of market conditions, the trading price of the stock, and other factors.

For the three and six months ended June 30, 2015, the Company repurchased 274,700 shares of its common stock at an average price of $10.88 per share for a total cost of approximately $3.0 million. At June 30, 2015, approximately $17.0 million remained available under the Company's share repurchase program.

8. Stock-based Awards

The Company’s 2005 Stock Incentive Plan (the “2005 Plan”) provided for granting of incentive stock options, non-qualified options, restricted stock, or other awards to the Company’s employees, officers, directors, and outside consultants up to an aggregate of 3,601,551 shares of the Company’s common stock. In conjunction with the effectiveness of the 2011 Equity Award Plan (the “2011 Plan”), the Company’s Board of Directors voted that no further stock options or other equity-based awards would be granted under the 2005 Plan.

The Company’s 2011 Plan provides for the issuance of stock options, restricted stock, restricted stock units, and other stock-based awards to the employees, officers, directors, and consultants of the Company or its subsidiaries. In connection with the approval of the 2011 Plan, the Company reserved 1,662,000 shares of common stock for issuance thereunder. On January 1st of each year, beginning January 1, 2012, the number of shares reserved under the 2011 Plan increased or will increase by the lesser of 1,500,000 shares, 4.0% of the outstanding shares of common stock and common stock equivalents, or another amount determined by the Company’s Board of Directors. As of June 30, 2015, 336,607 shares of common stock were available for future grant under the 2011 Plan.

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Stock-based awards granted to employees generally vest over a three- or four-year period, and, in the case of stock options, expire ten years from the date of grant. Certain awards provide for accelerated vesting if there is a change of control, as defined in the 2005 Plan or 2011 Plan, as applicable. The Company has generally granted stock options at exercise prices not less than the fair market value of its common stock on the date of grant.

Stock Options

The following summarizes stock option activity under stock incentive plans for the six months ended June 30, 2015:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands) (2)
Outstanding at December 31, 2014	3,080,439	$10.63		$ 11,456
Granted	499,000	13.47		
Exercised	(156,490)	10.46		
Forfeited	(236,731)	12.44		
Outstanding at June 30, 2015	3,186,218	$10.94	7.58	$ 4,691
Exercisable as of June 30, 2015	1,664,572	$10.54	6.61	$ 2,929
Vested and expected to vest as of June 30, 2015 (1)	2,867,329	$10.85	7.43	$ 4,389

(1) Represents the number of vested stock options as of June 30, 2015, plus the number of unvested stock options expected to vest as of June 30, 2015, based on the unvested stock options outstanding at June 30, 2015, adjusted for estimated forfeitures.

(2) The aggregate intrinsic value is calculated as the positive difference, if any, between the exercise price of the underlying stock options and the fair market value of the Company’s common stock on June 30, 2015.

The Company generally estimates the fair value of stock options on the date of grant using the Black-Scholes option-pricing model. This model requires the use of highly subjective estimates and assumptions, including expected stock price volatility, expected term of an award, risk-free interest rate, and expected dividend yield. The assumptions used to estimate the fair value of the stock options granted during the six months ended June 30, 2015 and 2014 using the Black-Scholes option-pricing model were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Weighted-average exercise price	$11.19	$9.69	$13.47	$10.43
Weighted-average grant-date fair value	$5.32	$4.92	$6.61	$5.35
Black-Scholes Assumptions				
Risk-free interest rate	1.54 %	2.02 %	1.72 %	2.07 %
Expected dividend yield	— %	— %	— %	— %
Expected volatility	49 %	52 %	50 %	52 %
Expected term (in years)	5.5 to 6.1	5.8 to 6.1	5.5 to 6.1	5.8 to 6.1

Total stock-based compensation expense recognized for the stock options was $1.0 million and $1.5 million for the three months ended June 30, 2015 and 2014, respectively, and $2.0 million and $2.7 million for the six months ended June 30, 2015 and 2014, respectively.

Restricted Stock Units

The Company recognizes non-cash compensation expense over the vesting term of restricted stock units. The fair value is measured based upon the number of units and the closing price of the Company’s common stock underlying such units on the dates of grant. During the six months ended June 30, 2015, the Company granted 536,211 restricted stock units. Upon vesting and settlement, each restricted stock unit entitles the holder to receive one share of common stock. Total stock-based compensation expense recognized for the restricted stock units was $0.9 million and $0.1 million for the three months ended

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June 30, 2015 and 2014, respectively, and $1.7 million and $0.1 million for the six months ended June 30, 2015 and 2014, respectively.
The following table summarizes restricted stock unit activity for the six months ended June 30, 2015:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock units as of December 31, 2014	849,619	$ 12.73
Restricted stock units granted	536,211	13.82
Restricted stock units vested	(79,275)	10.87
Restricted stock units forfeited	(107,750)	12.17
Unvested restricted stock units as of June 30, 2015	1,198,805	$ 13.39

Equity Awards with Market Based Vesting Conditions

In connection with the hiring of a new president and chief executive officer in the fourth quarter of 2014, the Company granted 250,000 options with market based vesting conditions at an exercise price equal to the fair market value per share of the common stock on the date of grant, $14.44. The vesting of these options is based on achieving target market prices of the common stock for a requisite Trading Period as described herein. There are four targets to be achieved, $15.00, $17.50, $20.00, and $22.50, with 62,500, or 25%, of the total options vesting at each target. The options shall vest on the first day after the completion of a period of twenty consecutive days in which the common stock has reached a target price, based upon the closing price (the "Trading Period").

In June 2015, the Company granted the chief financial officer 100,000 restricted stock units with market based vesting conditions. The 100,000 restricted stock units begin to accrue in 25% increments on each one-year anniversary of the date of grant, but do not become vested units, until the market based conditions are met (subject further to time based vesting conditions and continued employment). The vesting of any then accrued restricted stock units is based on achieving target market prices of the common stock for a requisite Trading Period. There are two targets to be achieved, $14.00 and $18.00 per share, with 50,000, or 50%, of the total award vesting at each target. The then accrued restricted stock units shall vest on the first day after the completion of a Trading Period, and any vesting thereafter will be contingent only on time based vesting and continued employment with the Company.
The Company estimates the fair value of equity awards with market based vesting conditions on the date of grant using a lattice model with a Monte-Carlo simulation. The model requires the use of subjective estimates and assumptions, including grant price, expected volatility, risk-free interest rate and dividend yield. The assumptions used to estimate the fair value of the equity awards with market based vesting conditions were as follows:

	Three Months Ended June 30, 2015
Weighted-average grant-date fair value	$11.32
Lattice Model Assumptions	
Risk-free interest rate	2.38 %
Expected dividend yield	— %
Expected volatility	49 %

The Company recognizes the stock-based compensation expense on equity awards with market based vesting conditions in our consolidated statements of operations on a straight-line basis over the requisite service period. Total stock-based compensation expense recognized for the equity awards with market based vesting conditions was $0.4 million and $1.0 million for the three and six month periods ended June 30, 2015.

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Stock-based Compensation Expense

Stock-based compensation is reflected in the consolidated statement of operations as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of revenues	$162	$126	$329	$243
Research and development	313	504	638	764
General and administrative	1,596	707	3,329	1,359
Sales and marketing	334	260	577	488
Total stock-based compensation expense	$2,405	$1,597	$4,873	$2,854

9. Income Taxes

Our effective income tax rates were (9.1%) and (5.8%) for the three and six months ended June 30, 2015, respectively. Our effective income tax rates were (0.4%) and (0.6%) for the three and six months ended June 30, 2014, respectively. Our effective income tax rate is based upon estimated income before provision for income taxes for the year, composition of the income in different countries, and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits and/or resolutions of tax audits or other tax contingencies. For the three and six months ended June 30, 2015, the effective income tax rate varied from the statutory income tax rate principally as a result of significant pre-tax book losses in the US and Switzerland that cannot be benefitted.

Our effective income tax rate in the three and six months ended June 30, 2015 differed from the three and six months ended June 30, 2014 primarily due to an increase in foreign earnings and non-deductible compensation as a result of the Company's recent acquisition of the German entity Mailstore Software GmbH ("MailStore").

The statute of limitations for assessment by the Internal Revenue Service (“IRS”) and state tax authorities is open for each of the tax years ending December 31, 2011 through 2014, although carryforward attributes that were generated prior to tax year 2011 may still be adjusted upon examination by the IRS or state tax authorities if they either have been or will be used in a future period. There are currently no federal or state audits in progress in the US. One of our German subsidiaries is currently under audit for the years ended 2011 through 2014. The statute of limitations for assessments by foreign taxing authorities is generally not open for years prior to 2010, although carryforward attributes that were generated prior to tax year 2010 may still be adjusted upon examinations.

10. Commitments and Contingencies

Operating Leases

The Company leases various facilities under leases that expire at varying dates through 2024. Certain of these leases contain renewal options and require the Company to pay operating costs, including property taxes, insurance, and maintenance.

The Company has lease agreements to rent office space in Boston, Massachusetts (corporate headquarters); Lewiston, Maine; Sunnyvale, California; Munich, Germany; and Viersen, Germany. The Company has lease agreements to rent data center space in Wakefield, Massachusetts; Phoenix, Arizona; and Chandler, Arizona. The Company also maintained a hosting service agreement with a third-party data center vendor in Somerville, Massachusetts, which ended on January 31, 2015. The terms of several of these leases include escalating rent and free rent periods. Accordingly, the Company recorded a deferred rent liability related to the free rent and escalating rent payments, such that rent is being recognized on a straight-line basis over the terms of the leases. At June 30, 2015 and December 31, 2014, $5.1 million and $4.8 million, respectively, was included in accrued expenses and other long-term liabilities related to the deferred rent.

In May 2014, the Company entered into a lease agreement for its new corporate headquarters in Boston, Massachusetts. The initial term of the lease expires on December 31, 2024, and the Company has the option to extend the original term of the lease for one successive five-year period. Upon execution of the lease agreement, the Company was required to post a security deposit of $0.8 million, which the Company maintains as a letter of credit. The Company’s landlord can draw against this letter of credit in the event of default by the Company. The facility was made available to the Company to begin its build-out on June 1, 2014, and as such, the Company began recording rent expense at that time. In accordance with the lease, the Company received a tenant improvement allowance. The rent expense is recorded net of the allowance over the term of the lease. The leasehold improvements associated with the initial build-out are being amortized over the initial term of the lease. Any

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additional leasehold improvements made during the course of occupancy will be amortized over the shorter of the useful life or remaining life of the lease.

Future non-cancellable minimum lease payments under all operating leases as of June 30, 2015, are as follows (in thousands):

Years Ended December 31,	Office Leases	Data Center Leases	Total
Remainder of 2015	$1,156	$1,345	$2,501
2016	2,068	793	2,861
2017	2,081	817	2,898
2018	2,181	275	2,456
2019	2,184	—	2,184
Thereafter	10,468	—	10,468
	$20,138	$3,230	$23,368

At June 30, 2015, the Company subleased certain office space to third parties, which sublease income will offset lease payments in the table above. Total sublease income under contractual terms is $1.6 million, with both the sublease and the underlying lease expiring in December 2016.

Other Non-cancellable Commitments

As of June 30, 2015, the Company had non-cancellable commitments to vendors primarily consisting of advertising, marketing and broadband services contracts, as follows (in thousands):

Years Ended December 31,	Commitments
Remainder of 2015	$3,306
2016	1,434
2017	693
2018	116
2019	35
	$5,584

Litigation

On August 30, 2010, Oasis Research, LLC ("Oasis Research") sued the Company and 17 other defendants in the United States Court for the Eastern District of Texas (the "Court") alleging infringement of certain of Oasis Research's patents. A trial was held in March 2013 and a jury verdict was returned against Oasis Research finding that all of the asserted patents were invalid based on a failure to list an inventor. On January 8, 2015, the Court granted Oasis Research's motion for Judgment as a Matter of Law under Rule 50(b) and Alternative Request for a New Trial under Rule 59(a). Consequently, all other issues remain in the case, including alleged infringement, invalidity, and Oasis Research's claims under the Racketeer Influenced and Corrupt Organizations ("RICO") Act. The Court has currently scheduled a trial on the RICO claims to begin on October 26, 2015 and a trial on alleged infringement and invalidity to begin on November 12, 2015. Based on its investigation to date, the Company believes that all asserted patents are not valid and/or the Company's products and services do not infringe. The Company also believes it has not violated the RICO statute, and will defend itself vigorously against any claims that it did.

The Company is not able to assess with certainty the outcome of this lawsuit or the amount or range of potential damages or future payments associated with this lawsuit at this time. While the Company intends to defend itself and prosecute its counterclaims vigorously, any litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending these lawsuits or their resolution will not have a material adverse impact on its business, operations, financial condition, or cash flows. Although the results of litigation and claims cannot be predicted with certainty, the Company is not presently involved in any other legal proceeding in which the outcome, if determined adversely to the Company, would be expected to have a material adverse effect on our business, operating results, or financial condition. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors.

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11. Retirement Plan

The Company has a 401(k) defined contribution savings plan for its employees who meet certain employment status and age requirements. The plan allows participants to defer a portion of their annual compensation on a pre-tax basis. Effective January 1, 2012, the Company elected to make a matching contribution of up to 4% of each employee's wages. For each of the three months ended June 30, 2015 and 2014, the Company's matching contributions to the plan were $0.3 million and $0.2 million, respectively. For each of the six months ended June 30, 2015 and 2014, the Company's matching contributions to the plan were $0.6 million and $0.4 million, respectively.

12. Restructuring

In the fourth quarter of 2014, the Company exited office space and relocated its corporate headquarters. The relocation was made to facilitate growth of the Company and the related increase in headcount. In association with the exit of the former office space, the Company recorded a charge at the cease-use date in accordance with ASC Topic 420, Exit or Disposal Cost Obligations. In the fourth quarter of 2014, the Company began a restructuring program to close its Somerville, Massachusetts data center and transition the computer equipment and operations located at the facility to its other Massachusetts data center. Activities related to this effort were initiated in the fourth quarter of 2014 and were completed by the end of the first quarter 2015. The Company recorded no restructuring charges for the three-month period ended June 30, 2015, and $0.1 million for the six-month period ended June 30, 2015.

As of June 30, 2015 and December 31, 2014, the Company had $0.3 million and $0.5 million accrued related to restructuring, respectively.

13. Revolving Credit Facility

On May 6, 2015, the Company and certain of our subsidiaries entered into a credit agreement with Silicon Valley Bank (the "Credit Facility"), which provides revolving credit financing of up to $25.0 million, including a $5.0 million sub-limit for letters of credit. The Credit Facility may be increased by up to an additional $25.0 million if the existing or additional lenders are willing to make such increased commitments and subject to other terms and conditions. The Credit Facility shall be available to the Company on a revolving basis during the period commencing on May 6, 2015 through May 6, 2018 at an interest rate of the Wall Street Journal prime rate plus 75 basis points or LIBOR plus 175 basis points, at the option of the Company.

The Credit Facility is secured by substantially all of the Company's assets and contains customary affirmative and negative covenants, including financial covenants specifying a minimum quick ratio and minimum consolidated free cash flow, in each case subject to customary and other exceptions for a credit facility of this size and type, each as further described in the Credit Facility. On May 22, 2015, the Company entered into an amendment to the Credit Facility, with Silicon Valley Bank (the "Amendment"), which amends the Company's existing Credit Facility. The Amendment eliminates from the events which constitute a change of control and, consequently, an event of default, the replacement, under specified circumstances, of a majority of the Company's board of directors. The Amendment also allows the Company to repurchase its capital stock pursuant to a board of directors approved stock repurchase plan, so long as the total of such repurchases does not exceed $20 million during the term of the Credit Facility and the Company remains in pro forma compliance with the financial and other covenants.

As of June 30, 2015, the Company was in compliance with these covenants and there was one letter of credit for $0.8 million outstanding under the Credit Facility related to the security deposit on the lease for the Company's corporate headquarters. Availability under the Credit Facility as of June 30, 2015 was $24.2 million.

14. Related Party Transactions

On July 21, 2015, the Company entered into an Evaluation Agreement with Storiant, Inc. ("Storiant"), a provider of enterprise storage solutions. David Friend, the Company's founder and current Executive Chairman, is chairman of the Board of Directors of Storiant, and Jeffry Flowers, the founder and Chief Executive Officer of Storiant, is a member of the Company's Board of Directors. The respective ownership interests of Mr. Friend and Mr. Flowers in the Company and Storiant, are described in the Company's Proxy Statement as filed with the SEC on May 11, 2015. The aggregate value of the transactions contemplated by the Evaluation Agreement is substantially less than $120,000, and the interests of each of Messrs. Friend and Flowers in such transactions arises from their respective ownership of equity securities in both the Company and Storiant.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as filed on March 10, 2015 with the SEC, as amended on Form 10-K/A, as filed with the SEC on May 1, 2015.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "will," "plan," "project," "seek," "sl "would," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included in this Quarterly Report on Form 10-Q. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We are a provider of cloud and hybrid business continuity solutions. Our solutions provide powerful features packaged in a cost-effective, simple and secure manner and are designed to address the specific needs of small and medium-sized businesses, or SMBs, and individuals.

We derive the majority of our revenue from subscription fees and the remainder of our revenue from software arrangements. For our subscription sales, we generally charge customers the full subscription amount at the beginning of each subscription period. Our tiered business offerings provide a fixed amount of cloud storage for an unlimited number of connected devices and customers can purchase additional cloud storage at any time after the commencement of a subscription. For individuals, we offer three different annual cloud backup solutions, each including unlimited storage for one computer.

We invest in customer acquisition because the market for business continuity solutions is highly competitive. Our sales model is designed to sell large volumes of our solutions to SMBs globally both directly and through our sales network, including distributors, value-added resellers, volume resellers, and major retailers. Our inside sales force supplements our channel efforts by, for example, following up on leads generated by our marketing programs and actively working to fulfill sales through our channel relationships. We support our go-to-market network with a marketing approach that leverages our established brand in order to drive market awareness and demand generation among the broad population of SMBs and individuals.

As we grow our business, we continue to invest in additional storage and infrastructure. Our operating costs continue to grow as our customers store more data, principally as a result of our investment in customer acquisition and research and development. We expect to continue to devote substantial resources to global expansion, customer acquisition, improving our technologies, and expanding our business continuity solutions. In addition, we expect to invest heavily in our operations to support anticipated growth and public company reporting and compliance obligations. We defer revenue over our customers' subscription periods but expense marketing costs as incurred. As a result of these factors, we expect to continue to incur GAAP operating losses on an annual basis for the foreseeable future.

Our Business Model

As the majority of our business is driven by subscription services, we evaluate the profitability of a customer relationship over its lifecycle because of the nature of our business model. We generally incur customer acquisition costs and capital equipment costs in advance of subscriptions while recognizing revenue ratably over the terms of the subscriptions. As a result,

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a customer relationship may not be profitable or result in positive cash flow at the beginning of the subscription period, even though it may be profitable or result in positive cash flow over the life of the customer relationship. While we offer monthly, annual and multi-year subscription plans, a significant majority of our customers are currently on annual subscription plans. The annual or multi-year commitments of our customers enhance management's visibility of our revenue, and charging customers at the beginning of the subscription period provides working capital.

Key Business Metrics

Our management regularly reviews a number of financial and operating metrics, including the following key metrics, to evaluate our business:

- Bookings. We calculate bookings as revenue recognized during a particular period plus the change in total deferred revenue net of foreign exchange (excluding deferred revenue recorded in connection with acquisitions) during the same period. Our management uses this measure as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the life of the subscription period.
- Annual retention rate. We calculate annual retention rate as the percentage of customers on the last day of the prior year who remain customers on the last day of the current year, or for quarterly presentations, the percentage of customers on the last day of the comparable quarter in the prior year who remain customers on the last day of the current quarter. Our management uses these measures to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships.
- Renewal rate. We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented. Our management uses this measure to monitor trends in customer renewal activity.
- Free cash flow. We calculate free cash flow by subtracting the cash paid for the purchase of property and equipment and adding the payments related to corporate headquarter relocation, acquisition-related payments, hostile takeover-related payments, CEO transition payments, litigation-related payments and the cash portion of the lease exit charge from net cash provided by operating activities. Our management uses free cash flow to assess our business performance and evaluate the amount of cash generated by our business.

Subscription renewals may vary during the year based on the date of our customers' original subscriptions. As we recognize subscription revenue ratably over the subscription period, this generally has not resulted in a material seasonal impact on our revenue but may result in material monthly and quarterly variances in one or more of the key business metrics described above.

Performance Highlights

The following table presents our performance highlights for the three- and six-months ended June 30, 2015 and 2014:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands, except percentage data)			
Key metrics (1):				
Bookings	$35,704	$30,618	$72,554	$63,104
Annual retention rate	83 %	83 %	83 %	83 %
Renewal rate	82 %	80 %	82 %	80 %
Free cash flow	$3,164	$1,470	$5,743	$5,713

(1) Refer to the Key Business Metrics section for the definition of these key metrics

Our bookings has increased by $5.1 million and $9.5 million for the three- and six-month periods ended June 30, 2015 compared to the corresponding period in 2014, respectively, as we continue to invest in customer acquisition in an effort to drive continued growth in bookings. Bookings for our small business solutions represented 37% of total bookings for the second quarter of 2015, up from 30% in the second quarter of 2014.

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Our free cash flow has increased by $1.7 million and $0.1 million for the three- and six-month periods ended June 30, 2015 compared to the corresponding period in 2014, respectively, primarily due to the timing of payments and growth in bookings during the second quarter of 2015.

Key Components of our Consolidated Statements of Operations

Revenue

We derive our revenue principally from subscription fees related to our service solutions as well as the sale of software and post-contract customer support. We typically charge a customer's credit card the full price of the subscription at the commencement of the subscription period and at each renewal date, unless the customer decides not to renew the subscription. We initially record a customer subscription fee as deferred revenue and then recognize it as revenue ratably, on a daily basis, over the life of the subscription period.

Cost of revenue

Cost of revenue consists primarily of costs associated with our data center operations and customer support centers, including wages and benefits for personnel, depreciation of equipment, amortization of developed technology, rent, utilities and broadband, equipment maintenance, software license fees, and allocated overhead. The expenses related to hosting our services and supporting our customers are related to the number of customers and the complexity of our services and hosting infrastructure. On a cost-per-GB stored basis, our costs have decreased due to decreases in storage prices and greater efficiency in our data center operations. We have also experienced a downward trend in the cost of storage equipment and broadband service, which we expect will continue in the future. We expect these expenses to increase in absolute dollars, but decrease as a percentage of revenue due to improved efficiencies in supporting customers.

Gross margin

Our gross margins have expanded due to the introduction of higher priced solutions targeting both small and medium-sized businesses and consumers, a downward trend in the cost of storage equipment and services, and efficiencies of our customer support personnel in supporting our customers. We expect these trends to continue.

Operating expenses

Research and development. Research and development expenses consist primarily of wages and benefits for development personnel, consulting fees, rent, and depreciation. We have focused our research and development efforts on both improving ease of use and functionality of our existing solutions and developing new solutions. The majority of our research and development employees are located at our corporate headquarters in the U.S. We expect that research and development expenses will increase in absolute dollars on an annual basis as we continue to enhance and expand our services, but decrease as a percentage of revenue over the long term, as we expect to grow our revenue at a faster rate.

General and administrative. General and administrative expenses consist primarily of wages and benefits for management, finance, accounting, human resources, legal and other administrative personnel, legal and accounting fees, insurance, and other corporate expenses. We expect that general and administrative expenses will increase in absolute dollars on an annual basis as we continue to add personnel and enhance our internal information systems in connection with the anticipated growth of our business and incur costs related to operating as a public company.

Sales and marketing. Sales and marketing expenses consist primarily of advertising costs, wages and benefits for sales and marketing personnel, creative expenses for advertising programs, credit card fees, commissions paid to third-party partners and affiliates, and the cost of providing free trials. The largest component of sales and marketing expense is advertising for customer acquisition, principally radio, online, television and print advertisements. Online search costs consist primarily of pay-per-click payments to search engine operators. Advertising costs are expensed as incurred. To date, marketing and advertising costs have been incurred principally in the U.S., but we may increase our marketing and advertising expenditures in other countries. We expect that we will continue to commit significant resources to our sales and marketing efforts to grow our business and awareness of our brand and solutions. We expect that sales and marketing expenses will continue to increase in absolute dollars on an annual basis, but decrease as a percentage of revenue over the long term, as we expect to grow our revenue at a faster rate.

Restructuring charges. Restructuring charges consist of costs associated with our data center optimization program. See Note 12-Restructuring to our consolidated financial statements included in this Quarterly Report on Form 10-Q for additional information.

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Critical Accounting Policies

Our financial statements are prepared in accordance with accounting principles generally accepted in the U.S., or GAAP. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions, and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances, but all such estimates and assumptions are inherently uncertain and unpredictable. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition.

We consider the assumptions and estimates associated with revenue recognition, business combinations, goodwill and acquired intangible assets, income taxes and stock-based compensation to be our critical accounting policies and estimates. For further information on our critical and other significant accounting policies, see the notes to the condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K, as filed on March 10, 2015 with the SEC, as amended on Form 10-K/A, as filed with the SEC on May 1, 2015.

Results of Operations

The following table sets forth, for the periods presented, data from our consolidated statements of operations as a percentage of revenue that each line item represents. The period-to-period comparison of financial results is not necessarily indicative of future results. The information contained in the table below should be read in conjunction with financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
	(% of revenue)							
Consolidated statements of operations data:								
Revenue	100.0	%	100.0	%	100.0	%	100.0	%
Cost of revenue	28.8		32.1		29.6		31.9	
Gross profit	71.2		67.9		70.4		68.1	
Operating expenses:								
Research and development	21.9		20.3		21.5		19.5	
General and administrative	22.5		12.6		22.6		12.4	
Sales and marketing	40.0		43.4		41.7		42.1	
Restructuring charges	0.0		0.0		0.2		—	
Total operating expenses	84.4		76.3		86.0		74.0	
Loss from operations	(13.2	)	(8.4	)	(15.6	)	(5.9	)
Interest and other (expense) income, net	0.2		—		—		—	
Loss before income taxes	(13.0	)	(8.4	)	(15.6	)	(5.9	)
Provision for income taxes	1.2		—		0.9		—	
Net loss	(14.2	)%	(8.4	)%	(16.5	)%	(5.9	)%

Comparison of the Three and Six Months Ended June 30, 2015 and 2014

Revenue

Three Months Ended June 30,			Six Months Ended June 30,		
2015	2014	Change	2015	2014	Change
(in thousands, except percentage data)					

Revenue	$33,972	$30,295	$3,677	12.1	%	$66,998	$59,433	$7,565	12.7	%

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Revenue increased for the three- and six-month periods ended June 30, 2015 as compared to the three- and six-month periods ended June 30, 2014, primarily due to increased sales of higher priced SMB solutions and revenue from our recently acquired MailStore product offering.

Cost of revenue, gross profit, and gross margin

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	Change		2015	2014	Change	
	(in thousands, except percentage data)							
Cost of revenue	$9,800	$9,721	$79	0.8 %	$19,814	$18,982	$832	4.4 %
Percent of revenue	28.8 %	32.1 %			29.6 %	31.9 %		
Components of cost of revenue:								
Personnel-related costs	$3,394	$3,247	$147	4.5 %	$6,948	$6,048	$900	14.9 %
Hosting and depreciation costs	5,011	5,447	(436)	(8.0)%	10,106	10,918	(812)	(7.4)%
Software, amortization and other	1,395	1,027	368	35.8 %	2,760	2,016	744	36.9 %
Total cost of revenue:	$9,800	$9,721	$79	0.8 %	$19,814	$18,982	$832	4.4 %
Gross profit	$24,172	$20,574	$3,598	17.5 %	$47,184	$40,451	$6,733	16.6 %
Gross margin	71.2 %	67.9 %			70.4 %	68.1 %		

Our gross margin improvement for the three- and six-month periods ended June 30, 2015 as compared to the three- and six-month periods ended June 30, 2014 was driven by an increase in sales of higher margin SMB products and efficiencies realized in our data centers. The increase in total costs of revenues is due primarily to an increase in personnel-related costs for our customer service organization and an increase in developed technology amortization related to the acquisition of MailStore, both partially offset by a decrease in depreciation costs.

Operating expenses

Research and development

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	Change		2015	2014	Change	
	(in thousands, except percentage data)							
Research and development	$7,448	$6,153	$1,295	21.0 %	$14,377	$11,575	$2,802	24.2 %
Percent of revenue	21.9 %	20.3 %			21.5 %	19.5 %		
Components of costs of research and development:								
Personnel-related costs	$5,572	$4,874	$698	14.3 %	$10,830	$9,077	$1,753	19.3 %
Third-party outsourcing costs	976	741	235	31.7 %	1,805	1,397	408	29.2 %
Hosting, consulting and other	900	538	362	67.3 %	1,742	1,101	641	58.2 %
Total research and development:	$7,448	$6,153	$1,295	21.0 %	$14,377	$11,575	$2,802	24.2 %

Research and development expenses increased for the three- and six-month periods ended June 30, 2015 as compared to the three- and six-month periods ended June 30, 2014, primarily as a result of an increase in personnel-related costs associated with additional research and development headcount, an increase in third-party outsourcing costs, software expenses and consulting expenses to further develop and enhance our products.

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General and administrative

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	Change		2015	2014	Change	
	(in thousands, except percentage data)							
General and administrative	$7,624	$3,831	$3,793	99.0 %	$15,200	$7,351	$7,849	106.8 %
Percent of revenue	22.5 %	12.6 %			22.6 %	12.4 %		
Components of general and administrative:								
Personnel-related costs	$4,465	$2,494	$1,971	79.0 %	$8,749	$4,644	$4,105	88.4 %
Professional fees	2,384	797	1,587	199.1 %	4,746	1,609	3,137	195.0 %
Consulting, taxes and other	775	540	235	43.5 %	1,705	1,098	607	55.3 %
Total general and administrative:	$7,624	$3,831	$3,793	99.0 %	$15,200	$7,351	$7,849	106.8 %

General and administrative expenses increased for the three- and six-month periods ended June 30, 2015 as compared to the three- and six-month period ended June 30, 2014 primarily as a result of increased personnel-related costs associated with additional headcount to support our overall growth and an increase in professional fees primarily related to litigation expenses and hostile takeover-related expenses that occurred in the current year.

Sales and marketing

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015	2014	Change		2015	2014	Change	
	(in thousands, except percentage data)							
Sales and marketing	$13,570	$13,132	$438	3.3 %	$27,951	$25,005	$2,946	11.8 %
Percent of revenue	40.0 %	43.4 %			41.7 %	42.1 %		
Components of sales and marketing:								
Personnel-related costs	$4,832	$3,366	$1,466	43.6 %	$9,868	$6,013	$3,855	64.1 %
Advertising costs	3,958	5,328	(1,370)	(25.7)%	7,976	10,748	(2,772)	(25.8)%
Costs of credit card transactions and offering free trials	2,031	1,563	468	29.9 %	3,800	3,067	733	23.9 %
Agency fees, consulting and other	2,749	2,875	(126)	(4.4)%	6,307	5,177	1,130	21.8 %
Total sales and marketing:	$13,570	$13,132	$438	3.3 %	$27,951	$25,005	$2,946	11.8 %

Sales and marketing expenses increased for the three-month period ended June 30, 2015 as compared to the three-month period ended June 30, 2014, primarily due to increased personnel-related costs associated with increased headcount on our sales team, partially offset by decreased advertising-related costs associated with a reduction in our traditional radio and television advertising spend.

Sales and marketing expenses increased for the six-month period ended June 30, 2015 as compared to the six-month period ended June 30, 2014, primarily due to increased personnel-related costs associated with increased headcount on our sales team and an increase of agency fees, consulting and other costs related to increased investments in our indirect channel organization both domestically and internationally, partially offset by decreased advertising-related costs associated with a reduction in our traditional radio and television advertising spend.

Other Financial Data

In addition to our results discussed above determined under GAAP, we believe that bookings, annual retention rate, renewal rate, and free cash flow are useful to investors in evaluating our operating performance. Refer to the Performance Highlights section for the table presenting our performance highlights for the three and six months ended

June 30, 2015 and 2014. Management considers these financial and operating metrics critical to understanding our business, reviewing our

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historical performance, measuring and identifying current and future trends, and for planning purposes. Securities analysts also frequently use bookings and free cash flow as supplemental measures to evaluate the overall performances of companies.

Bookings and free cash flow are financial data that are not calculated in accordance with GAAP. The tables below provide reconciliation of bookings and free cash flow to revenue and cash provided by (used in) operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

Our management uses annual retention rate to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships. As customers' annual and multi-year subscriptions come up for renewal throughout the calendar year based on the dates of their original subscriptions, measuring retention on a trailing twelve month basis at the end of each quarter provides our management with useful and timely information about the stability of our customer base. Management uses renewal rate to monitor trends in customer renewal activity.

Our management uses bookings as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the life of the subscription period. Management uses free cash flow as a measure of our operating performance; for planning purposes, including the preparation of our annual operating budget; to allocate resources to enhance the financial performance of our business; to evaluate the effectiveness of our business strategies; to provide consistency and comparability with past financial performance; to determine capital requirements; to facilitate a comparison of our results with those of other companies; and in communications with our Board of Directors concerning our financial performance. We also use free cash flow as a factor when determining management's incentive compensation. Management believes that the use of free cash flow provides consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations, and also facilitates comparisons with other peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results.

Although bookings and free cash flow are frequently used by investors and securities analysts in their evaluations of companies, bookings and free cash flow have limitations as analytical tools, and you should not consider them in isolation or as substitutes for analysis of our results of operations as reported under GAAP. Some of these limitations are:

- bookings does not reflect our receipt of payment from customers;
- free cash flow does not reflect our future requirements for contractual commitments to vendors;
- free cash flow does not reflect the non-cash component of employee compensation or depreciation and amortization of property and equipment; and
- other companies in our industry may calculate bookings or free cash flow or similarly titled measures differently than we do, limiting their usefulness as comparative measures.

The following tables present reconciliations of our bookings and free cash flow to revenue and cash provided by operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Revenue	$33,972	$30,295	$66,998	$59,433
Add change in deferred revenue, net of foreign exchange	1,732	323	5,556	3,671
Bookings (1)	$35,704	$30,618	$72,554	$63,104

(1) Bookings is inclusive of MailStore since the acquisition date in December 2014

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Cash provided by operating activities	$3,976	$3,275	$6,547	$10,600
Subtract capital expenditures	(1,617)	(1,895)	(4,906)	(5,040)
Add payments related to corporate headquarter relocation	—	90	1,309	153
Add acquisition-related payments	306	—	381	—
Add hostile takeover-related payments	401	—	1,663	—
Add CEO transition expenses	—	—	29	—
Add cash portion of lease exit charge	89	—	711	—
Add litigation-related payments	9	—	9	—
Free cash flow	$3,164	$1,470	$5,743	$5,713

Liquidity and Capital Resources

As of June 30, 2015, we had cash and cash equivalents and marketable securities of $64.9 million, which consisted of cash, money market funds, U.S. agency and treasury securities, and certificates of deposit. We have available borrowings under our revolving credit facility of up to $25 million, which we can draw down on through May 6, 2018.

Sources of funds

We believe, based on our current operating plan, that our existing cash and cash equivalents, marketable securities, cash provided by operations, and borrowings available under our revolving credit facility will be sufficient to meet our anticipated cash needs for at least the next 12 months.

From time to time, we may explore additional financing sources to develop or enhance our solutions, fund expansion, respond to competitive pressures, acquire or to invest in complementary products, businesses or technologies, or to lower our cost of capital, which could include equity, equity-linked, and debt financing. There can be no assurance that any additional financing will be available to us on acceptable terms, if at all. If we raise additional funds through the issuance of equity or convertible debt or other equity-linked securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock.

Our revolving credit facility allows us to borrow up to $25 million, including a $5.0 million sub-limit for letters of credit, through May 6, 2018. Our revolving credit facility may be increased by up to an additional $25.0 million if the existing or additional lenders are willing to make such increased commitments and subject to other terms and conditions. Our revolving credit facility shall be available to us at an interest rate of the Wall Street Journal prime rate plus 75 basis points or LIBOR plus 175 basis points, at our option, and is secured by substantially all of our assets and contains customary affirmative and negative covenants, including financial covenants specifying a minimum quick ratio and minimum consolidated free cash flow, in each case subject to customary and other exceptions for a credit facility of this size and type. To date, we were in compliance with these covenants and there was one letter of credit for $0.8 million outstanding under the credit facility related to the security deposit for our corporate headquarters. To date, the availability under the credit facility was $24.2 million.

Uses of funds

We have increased our operating and capital expenditures in connection with the growth in our operations and the increase in our personnel, and we anticipate that we will continue to increase such expenditures in the future. Our future capital requirements may vary materially from those now planned and will depend on many factors, including:

- potential future acquisition opportunities;
- the levels of advertising and promotion required to acquire and retain customers;
- expansion of our data center infrastructure necessary to support our growth;
- growth of our operations in the U.S. and worldwide;
- our development and introduction of new solutions; and

- the expansion of our sales, customer support, research and development, and marketing organizations.

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Future capital expenditures will focus on acquiring additional data storage and hosting capacity and general corporate infrastructure. We are not currently party to any purchase contracts related to future capital expenditures, other than short-term purchase orders.

Cash flows

The following table summarizes our net cash inflows (outflows) for the six months ended June 30, 2015 and 2014.

	Six Months Ended June 30,	
	2015	2014
	(in thousands)	
Net cash provided by operating activities	$6,547	$10,600
Net cash provided by (used in) investing activities	9,826	(5,040)
Net cash (used in) provided by financing activities	(1,368)	1,408

Operating activities

Our cash flows from operating activities are significantly influenced by the amount of our net loss, growth in subscription sales and customer growth, changes in working capital accounts, the timing of prepayments and payments to vendors, add-backs of non-cash expense items such as depreciation and amortization, and stock-based compensation expense.

In the six months ended June 30, 2015, cash provided by operating activities was $6.5 million, which was primarily driven by a $5.6 million increase in deferred revenue associated with an increase in subscription sales and customer growth. Net cash inflows from operating activities for the six months ended June 30, 2015 included non-cash charges of $11.7 million, including $6.8 million of depreciation and amortization and $4.9 million of stock-based compensation expense, and an increase in other assets and long-term liabilities of $0.5 million. These cash inflows were partially offset by our net loss of $11.1 million and a decrease in working capital of $0.2 million, due primarily to timing of payments and customer receipts.

In the six months ended June 30, 2014, cash provided by operating activities was $10.6 million, which was primarily driven by a $3.7 million increase in deferred revenue associated with the increase in subscription sales and customer growth. Net cash inflows from operating activities for the six months ended June 30, 2014 included non-cash charges of $9.2 million, including $6.3 million of depreciation and amortization and $2.9 million of stock-based compensation, an increase in other assets and long-term liabilities of $0.9 million and an increase in working capital of $0.3 million. These cash inflows were partially offset by our net loss of $3.5 million.

Investing activities

In the six months ended June 30, 2015, cash provided in investing activities was $9.8 million, which was primarily driven by a $14.4 million increase in cash relating to proceeds from maturities of marketable securities and derivatives and a $0.7 million increase relating to a decrease in restricted cash, partially offset by capital expenditures of $4.9 million and a purchase of marketable securities and derivatives of $0.4 million.

In the six months ended June 30, 2014, cash used in investing activities was $5.0 million, consisting of capital expenditures of $5.0 million.

Financing activities

In the six months ended June 30, 2015, cash used in financing activities was $1.4 million, which was primarily driven by a $3.0 million repurchase of common stock, partially offset by net proceeds from the exercise of stock options of $1.6 million.

In the six months ended June 30, 2014, cash provided by financing activities was $1.4 million, consisting of net proceeds from the exercise of stock options.

Off-balance sheet arrangements

As of June 30, 2015, we did not have any off-balance sheet arrangements.

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Contractual obligations

The following table summarizes our contractual obligations at June 30, 2015 (in thousands):

	Payment Due by Period (1)				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(in thousands)				
Office lease obligations	$20,138	$2,189	$4,205	$4,322	$9,422
Hosting facility lease obligations	3,230	1,737	1,493	—	—
Other purchase commitments	5,584	3,306	2,127	116	35
Total	$				