Shutterstock, Inc.
Form 10-Q
May 09, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 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: 001-35669

SHUTTERSTOCK, INC.

(Exact name of registrant as specified in its charter)

Delaware	**80-0812659**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Jonathan Oringer

Chief Executive Officer

Shutterstock, Inc.

350 Fifth Avenue, 21st Floor

New York, NY 10118

(Address of principal executive offices, including zip code)

(646) 419-4452

(Registrant s telephone number, including area code)

Indicate by check mark whether 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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o 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.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	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). o Yes x No

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

Class	Outstanding at May 7, 2014
Common Stock, $0.01 par value per share	**35,197,284**

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Shutterstock, Inc.

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology such as believe, may, estimate, continue, anticipate, intend, expect, predict, potential , project, guidance, target, forecast

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made and/or management s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements as a result of certain factors, as more fully described in Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q and in the reports and documents filed from time to time by us with the Securities and Exchange Commission (the SEC).

Forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

WHERE YOU CAN FIND MORE INFORMATION

Shutterstock s corporate website is located at *www.shutterstock.com*. Shutterstock makes available free of charge, on our corporate website, our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing to, the SEC. Information contained on Shutterstock s corporate website is not part of this report or any other report filed with the SEC.

Unless the context otherwise indicates, references in this report to the terms Shutterstock, the Company, we, our and us refer to Shutterstock, Inc. and its subsidiaries.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

Shutterstock, Inc.

Consolidated Balance Sheets

(In thousands, except per share data)

		March 31, 2014 (unaudited)		December 31, 2013
ASSETS				
Current assets:				
Cash and cash equivalents	$	157,978	$	155,355
Short-term investments		54,994		54,429
Credit card receivables		3,012		2,083
Accounts receivable, net		8,143		6,081
Prepaid expenses and other current assets		22,472		19,809
Deferred tax assets, net		3,948		5,431
Total current assets		250,547		243,188
Property and equipment, net		25,798		20,256
Intangible assets, net		4,717		853
Goodwill		10,186		1,423
Deferred tax assets, net		13,417		10,720
Other assets		2,095		2,048
Total assets	$	306,760	$	278,488
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	5,446	$	4,164
Accrued expenses		18,999		23,638
Contributor royalties payable		10,942		9,180
Deferred revenue		60,855		52,100
Other liabilities		1,845		2,846
Total current liabilities		98,087		91,928
Other non-current liabilities		9,552		3,961
Total liabilities		107,639		95,889
Commitments and contingencies (Note 8)				
Stockholders equity:				
Common stock, $0.01 par value; 200,000 shares authorized; 35,196 and 35,071 shares outstanding as of March 31, 2014 and December 31, 2013, respectively		352		351
Additional paid-in capital		139,035		127,443
Accumulated comprehensive income		20		9
Retained earnings		59,714		54,796
Total stockholders equity		199,121		182,599
Total liabilities and stockholders equity	$	306,760	$	278,488

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

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Shutterstock, Inc.

Consolidated Statements of Operations

(In thousands, except for share and per share data)

(unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Revenue	$ 72,777	$ 51,117
Operating expenses:		
Cost of revenue	29,108	19,821
Sales and marketing	19,276	11,978
Product development	7,777	4,555
General and administrative	7,517	4,780
Total operating expenses	63,678	41,134
Income from operations	9,099	9,983
Other income (expense), net	21	(12)
Income before income taxes	9,120	9,971
Provision for income taxes	4,202	4,406
Net income	$ 4,918	$ 5,565
Less:		
Preferred interest distributed		
Undistributed earnings to participating stockholder/members	11	19
Net income available to common stockholders/members	$ 4,907	$ 5,546
Net income per basic share available to common stockholders/members:		
Distributed	$	$
Undistributed	0.14	0.17
Basic	$ 0.14	$ 0.17
Net income per diluted share available to common stockholders/members:		
Distributed	$	$
Undistributed	0.14	0.16
Diluted	$ 0.14	$ 0.16
Weighted average shares outstanding:		
Basic	35,027,480	33,398,797
Diluted	35,838,853	33,851,843

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

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Shutterstock, Inc.

Consolidated Statements of Comprehensive Income

(In thousands)

(unaudited)

	Three Months Ended March 31	
	2014	2013
Net income	$ 4,918	$ 5,565
Foreign currency translation gain	4	
Unrealized gain on investments	7	
Other comprehensive income	11	
Comprehensive income	$ 4,929	$ 5,565

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Shutterstock, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Three Months Ended March 31, 2014		Three Months Ended March 31, 2013	
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	$	4,918	$	5,565
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		1,551		779
Write-off of property and equipment		367		
Deferred taxes		(402)		(1,692)
Non-cash equity-based compensation		3,137		1,016
Excess tax benefit from the exercise of stock options		(6,345)		
Bad debt reserve		62		84
Chargeback reserve and sales refund reserve		45		20
Amortization of deferred financing fees				125
Changes in operating assets and liabilities:				
Credit card receivables		(928)		(845)
Accounts receivable		(2,124)		(964)
Prepaid expenses and other current and non-current assets		3,693		(259)
Accounts payable and other liabilities		2,221		(1,069)
Contributors royalties payable		1,762		1,002
Income taxes payable				4,626
Deferred revenue		7,672		5,402
Net cash provided by operating activities	$	15,629	$	13,790
CASH FLOWS FROM INVESTING ACTIVITIES				
Capital expenditures		(10,881)		(1,127)
Purchase of investments		(70,492)		
Sale and maturities of investments		69,935		
Acquisition of business		(10,056)		
Security deposit payment		(49)		(1,779)
Net cash used in investing activities	$	(21,543)	$	(2,906)
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from exercise of stock options		2,188		53
Excess tax benefit from the exercise of stock options		6,345		
Payment of term loan				(6,000)
Payment of offering fees				(20)
Net cash provided by (used in) financing activities	$	8,533	$	(5,967)
Effect of foreign exchange rates changes on cash		4		
Net increase in cash and cash equivalents		2,623		4,917
Cash and cash equivalents Beginning		155,355		102,096
Cash and cash equivalents Ending	$	157,978	$	107,013
Supplemental Disclosure of Cash Information:				
Cash paid for:				
Income taxes	$	55	$	1,264
Interest	$		$	34

Supplemental Disclosure of Non-Cash Investing and Financing Activities:				
Capital expenditures in accounts payable and other liabilities	$	3,473	$	

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

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Shutterstock, Inc.

Notes to Unaudited Consolidated Financial Statements

(In Thousands, Except Share and Per Share Data)

(1) Summary of Operations and Significant Accounting Policies

Summary of Operations

Shutterstock, Inc. (the Company or Shutterstock) operates an industry-leading global marketplace for commercial digital imagery. Commercial digital imagery consists of licensed photographs, illustrations and videos that companies use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content. The Company licenses commercial digital imagery to its customers. Contributors upload their digital imagery to the Company s website in exchange for a royalty payment based on customer download activity. The Company is headquartered in New York City with offices in London, Berlin, Chicago, Denver and San Francisco.

Principles of Consolidation

The consolidated financial statements reflect the operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Reorganization

In May 2012, in connection with the filing of a registration statement for the Company s initial public offering (the IPO), Shutterstock Images LLC, a New York limited liability company (the LLC) formed Shutterstock, Inc., a Delaware corporation, as a wholly-owned subsidiary of the LLC. On October 5, 2012, the LLC reorganized, by way of a merger of the LLC with and into Shutterstock, Inc. with Shutterstock, Inc. surviving in the merger (the Reorganization). In connection with the Reorganization, the preferred and common membership interests in the LLC, including any interests that vested upon the Reorganization, were exchanged for an aggregate of 28,338,281 shares of Shutterstock, Inc. common stock.

Unaudited Interim Financial Statements

The interim consolidated balance sheet as of March 31, 2014 and the consolidated statements of operations, comprehensive income and cash flows for the three months ended March 31, 2014 and 2013 are unaudited. The unaudited interim financial statements have been prepared on a basis consistent with the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company s financial position as of March 31, 2014 and its results of consolidated operations, comprehensive income and cash flows for the three months ended March 31, 2014 and 2013. The financial data and the other financial information disclosed in these notes to the financial statements related to these periods are also unaudited. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the year ending December 31, 2014 or for any other future annual or interim period.

There have been no changes in the significant accounting policies from those that were disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on February 28, 2014. These financial statements should also be read in conjunction with the audited Consolidated Financial Statements and Notes thereto for the year ended December 31, 2013. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2013 included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP.

Acquisition of Virtual Moment, LLC

On March 14, 2014, the Company acquired certain assets and certain liabilities of Virtual Moment, LLC (dba WebDAM) (WebDAM) pursuant to an asset purchase arrangement. The transaction was accounted for using the acquisition method, and accordingly, the results of the acquired business have been included in the Company s results of operations from the acquisition date. The acquisition did not have a material impact on the Company s reported operating results.

WebDAM sells digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. WebDAM s products help organizations manage, search, distribute and collaborate on creative digital files in order to grow their brands and reach new audiences. WebDAM s offerings are particularly attractive to large enterprises, which make up a significant portion of their client base. The Company believes that this acquisition will increase its strategic position with its enterprise customers as well as broaden its product availability to seize market opportunity.

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The fair value of consideration transferred in this business combination is allocated to the intangible assets acquired and liabilities assumed at the acquisition date, with the remaining unallocated amount, if any, recorded as goodwill. The allocation of the acquisition price for this acquisition has been prepared on a preliminary basis, and changes to those allocations may occur as additional information becomes available.

The total preliminary purchase price of $12,416 consists of an initial cash payment of $10,056 and $2,360 in contingent consideration based on certain performance criteria of post-acquisition revenue. As of March 31, 2014, the fair value of the post-acquisition revenue performance-based contingent consideration is included in other non-current liabilities. The fair value of the contingent consideration was determined using a Monte-Carlo simulation approach. The preliminary aggregate purchase price was allocated to the assets acquired and liabilities assumed as follows:

Intangible assets:		
Trade name	$	500
Customer relationships		2,800
Developed technology		600
Goodwill		8,763
Total assets acquired		836
Total liabilities assumed		(1,083)
Total	$	12,416

The identifiable intangible assets have a weighted average life of approximately 7 years and are being amortized on a straight-line basis. The fair value of the customer relationships was determined using a variation of the income approach known as excess earnings method. The fair values of the trade name and developed technology were both determined using the relief-from-royalty method. The goodwill arising from the transaction is primarily attributable to expected operational synergies and is deductible for income tax purposes. As a result of the acquisition, the Company recorded approximately $300 of professional fees for the three months ended March 31, 2014 which is included in general and administrative expense.

Pro forma results of operations have not been presented because the effect of this business combination was not material to the Company s consolidated results of operations.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company s management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. The Company evaluates its significant estimates on an ongoing basis, including, but not limited to allowance for doubtful accounts, sales refund reserve, goodwill, intangibles, non-cash equity-based compensation, income tax provision and for certain non-income tax accruals. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

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Restricted Cash

The Company s restricted cash relates to security deposits for leased office locations. As of March 31, 2014 and December 31, 2013, the Company had $243 of restricted cash recorded in prepaid expenses and other current assets that related to a leased office location that expires in 2014 and had $2,017 of restricted cash recorded in other assets that related to leased office locations that expire in 2015 and 2024, respectively. The carrying value of restricted cash approximates fair value.

Revenue Recognition

All revenue, net of chargebacks and refunds, is generated from the license of digital content through subscription or usage based plans. The Company s three primary plans are: subscription plans, On Demand plans, and credit pack plans. The Company recognizes revenue when all of the following basic criteria are met: there is persuasive evidence of an arrangement, performance or delivery of services has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The Company considers persuasive evidence of an arrangement to be an electronic order form, or a signed contract, which contains the fixed pricing terms. Performance or delivery is considered to have occurred upon the ratable passage of time for subscription plans, the download of digital content or the expiration of a contract period for which there are unused downloads or credits. Collectability is reasonably assured since most of the Company s customers purchase products by making electronic payments at the time of a transaction with a credit card. The Company establishes a chargeback allowance and sales refund reserve allowance based on factors surrounding historical credit card chargeback trends, historical sales refund trends and other information. As of March 31, 2014 and December 31, 2013, the Company has recorded a chargeback allowance and sales refund allowance of $470 and $425, respectively, which is included in other liabilities. Collectability is assessed for customers who pay on credit based on a credit evaluation for new customers, when necessary, and transaction history with existing customers. Any cash received in advance of revenue recognition is recorded as deferred revenue.

Subscription plans range in length from thirty days to one year. Subscription plan revenues are recognized on a straight-line basis using a daily convention method over the plan term. On Demand plans are typically for a one-year term and permit the customer to download up to a fixed amount of digital content. On Demand revenues are recognized at the time the customer downloads the digital content on a per unit basis. Revenue related to unused digital content, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Credit pack plans are generally for a one-year term and enable the customer to purchase a fixed number of credits which can then be utilized to pay for downloaded digital content. The number of credits utilized for each download depends on the digital content size and format. Credit pack revenue is recognized based on customer usage on a per credit basis as digital content is downloaded. Revenue related to unused credits, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Most plans automatically renew at the end of the plan term unless the customer elects not to renew. The Company recognizes revenue from its three types of plans on a gross basis in accordance with the authoritative guidance on principal-agent considerations as the Company is the primary obligor in the arrangement, has control in establishing the product s price, performs a detailed review of the digital content before accepting it to its collection to ensure it is of high quality before it may be purchased by the customers, can reject contributor s images in its sole discretion, and has credit risk.

Customers typically pay in advance (or upon commencement of the term) via credit card, wire or check. Fees paid or invoiced in advance are deferred and recognized as described above. Customers that do not pay in advance are invoiced and are required to make payment under standard credit terms. The Company does not generally offer refunds or the right of return to customers. There are situations in which a customer may receive a refund but the determination is made on a case-by-case basis.

The Company also licenses digital content to customers through third party resellers. The Company contracts with third party resellers around the world to access markets where the Company does not have a significant presence. Third party resellers sell the Company s products directly to end-user customers and remit a fixed amount to the Company based on the type of plan sold. The terms of the reseller program indicate that the third party reseller is the primary obligor to the end-user customer and bears the risks and rewards as principal in the transaction. In assessing whether the Company s revenue should be reported on a gross or net basis with respect to our reseller program, the Company follows the authoritative guidance in ASC 605-45, Principal Agent Considerations. The Company recognizes revenue net of reseller commission in accordance with the type of plan sold, consistent with the plan descriptions above. The Company generally does not offer refunds or the right of return to resellers.

Equity-Based Compensation

The Company measures and recognizes non-cash equity-based compensation expense for all equity-based payment awards made to employees based on estimated fair values. The value portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period. For awards with a change of control condition, an evaluation is made at the grant date and

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future periods as to the likelihood of the condition being met. Compensation expense is adjusted in future periods for subsequent changes in the expected outcome of the change of control conditions until the vesting date. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company uses the Black Scholes option pricing model to determine the fair value of stock options and other equity-based awards granted pursuant to the Value Appreciation Rights Plan (VAR Plan), 2012 Omnibus Equity Incentive Plan (the 2012 Plan) and stock purchased pursuant to the Employee Stock Purchase Plan (2012 ESPP), which are discussed further in Note 11, Equity-Based Compensation.

The determination of the grant date fair value using an option-pricing model requires judgment as well as assumptions regarding a number of other complex and subjective variables. These variables include the Company s fair value of the common ownership interest pre-IPO, the Company s closing market price at the grant date post-IPO, the expected unit price volatility over the expected term of the awards, awards exercise and cancellation behaviors, risk-free interest rates, and expected dividends, which are estimated as follows:

- ***Fair Value of Common Membership Unit.*** Prior to completion of the IPO, the Company s fair value of common ownership interest was estimated internally and approved by the Board of Managers (BOM) because the Company was not publicly traded. The Company s intention upon granting VAR Plan awards was for the granted award to have exercisable price per unit that was not less than the per unit fair value of the Company s common equity on the date of grant. The valuations of the Company s common equity unit were prepared in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services 1: *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. The assumptions used in the valuation model were based on future expectations combined with the Company s judgment. In the absence of a public trading market, the Company exercised significant judgment and considered numerous objective and subjective factors to determine the fair value of the common equity unit as of the date of each VAR Plan award grant. Some but not all of these factors included operating and financial performance, current business conditions and projections, the hiring of key personnel, the Company s history and introduction of new functionality and services, the Company s stage of development, the likelihood of achieving a liquidity event for the common ownership interests, any adjustment necessary to recognize a lack of marketability for our common ownership interests, the market performance of comparable publicly traded companies, and U.S. and global capital market conditions. The Company also obtained independent third party valuations on a periodic basis. After October 11, 2012, the date the Company s common stock began trading on the NYSE, the grant date fair value for stock-based awards is based on the closing price of the Company s common stock on the NYSE on the date of grant and fair value for all other purposes related to stock-based awards shall be the closing price of the Company s common stock on the NYSE on the relevant date.

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- ***Expected Term.*** The expected term is estimated using the simplified method allowed under Securities and Exchange Commission (SEC) guidance.

- ***Volatility.*** As the Company does not have a trading history for its common ownership interest pre-IPO or a significant range of its common stock post-IPO, the expected price volatility for the common ownership interest and common stock was estimated by taking the average historic price volatility for industry peers based on daily price observations over a period equivalent to the expected term of the VAR Plan awards and stock options granted post-IPO. Industry peers consist of several public companies similar in size, stage of life cycle and financial leverage. The Company did not rely on implied volatilities of traded options in the industry peers common stock because the volume of activity was relatively low. The Company intends to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of the Company s own common stock becomes available, or unless circumstances change such that the identified companies are no longer similar to the Company, in which case, more suitable companies whose share prices are publicly available would be utilized in the calculation.

- ***Risk-free Interest Rate.*** The risk-free interest rate is based on the yields of U.S. Treasury securities with maturities similar to the expected term of each award group.

- ***Dividend Yield.*** Prior to the Reorganization, the Company has historically paid cash dividends or distributions to its members. Following the Reorganization, the Company has not paid cash distributions to its stockholders and it does not intend to do so for the foreseeable future. As a result, the Company used an expected dividend yield of zero.

If any of the assumptions used in the Black-Scholes model changes significantly, the fair value for future awards may differ materially compared with the awards granted previously. The awards granted pursuant to the VAR Plan, the 2012 Plan, and the 2012 ESPP are subject to a time-based vesting requirement. The majority of stock option awards granted under the 2012 Plan vest over four years while the majority of the restricted stock units granted under the 2012 Plan vest over three years. The 2012 ESPP provides for purchase periods approximately every six months and a participant must be employed on the purchase date to participate. The VAR Plan awards had a condition that a change of control (as defined in the VAR Plan) must occur for a payment to trigger with respect to the VAR Plan awards. In connection with the Company s Reorganization, all of the VAR Plan awards were exchanged for options to purchase shares of common stock of Shutterstock, Inc. As of December 31, 2011, no equity-based compensation expense had been recognized with respect to the VAR Plan awards because the qualifying event had not occurred. As a result of the completion of the initial public offering (IPO) in October 2012, the Company began recording stock-based compensation expense using the accelerated attribution method, net of forfeitures, based on the grant date fair value of the VAR Plan awards that were exchanged for options to purchase shares of common stock of Shutterstock, Inc. as part of the Company s Reorganization.

For any equity based awards that qualified for liability classification pre-IPO, the Company has elected to use the intrinsic value method to value the common membership interest in accordance with authoritative guidance on stock compensation. See Note 11, Equity Based Compensation, for further information.

Income Taxes

The Company is a Delaware corporation. Significant management judgment is required in projecting ordinary income/(loss) in order to determine the Company s estimated effective tax rate.

The Company accounts for unrecognized tax benefits using a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. The Company records an income tax liability, if any, for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on the Company s tax returns. To the extent that the assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. The reserves are adjusted in light of changing facts and circumstances, such as the outcome of a tax audit or lapses in statutes of limitations. Any reserve for uncertain tax provisions, if any, and related penalties and interest, if any, are included in the income tax provision.

The Company assessed the realizability of deferred tax assets and determined that based on the available evidence, including a history of taxable income and estimates of future taxable income, it is more likely than not that the deferred tax assets will be realized. The Company will continue to evaluate its ability to realize deferred tax assets on a quarterly basis. Significant management judgment is required in determining the provision for income taxes and deferred tax assets and liabilities. In the event that actual results differ from these estimates, the Company will adjust these estimates in future periods which may result in a change in the effective tax rate in a future year.

The Company is subject to certain compliance requirements for non income taxes, value added and sales based taxes. Where appropriate, the Company has made accruals for these taxes, which are reflected in the Company s consolidated financial statements.

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Net Income Per Share

Basic net income per share is computed by dividing the net income attributable to common stockholders/members by the weighted average number of common shares outstanding during the period. The Company applies the two class method for calculating and presenting income per share. Under the two-class method, net income is allocated between shares of common stock and other participating securities based on their contractual participating rights to share in the earnings as if all of the earnings for the period have been distributed. Participating securities are defined as securities that participate in dividends with common stock according to a pre-determined formula or a contractual obligation to share in the income of the entity. Any potential issuance of common shares, including those that are contingent and do not participate in dividends, are excluded from weighted average number of common shares outstanding. Undistributed net income (loss) for a given period is apportioned to participating members based on the weighted average number of each class of securities outstanding during the applicable period as a percentage of the combined weighted average number of these securities outstanding during the period. Income available to common shareholders/members is computed by deducting dividends paid to preferred members, accretion to redemption value on preferred members shares, less income allocated to participating securities including unvested shares for the restricted award holder since these unvested shares have participating rights. See Note 11, Equity Based Compensation, for further discussion.

Diluted net income per share is computed by dividing the net income available to common shareholders/members adjusted for any changes in income that would result from the assumed conversion of the potential common shares by the weighted average common shares outstanding and all potential common shares, if they are dilutive. Diluted net income available to common stockholders/members for the three months ended March 31, 2014 and 2013 includes the effect of 2,088,181 and 1,837,251 shares, respectively, while 179,883 and 53,750 shares, respectively, were excluded since they were anti-dilutive.

A reconciliation of assumed exercised shares used in calculating basic and diluted income (loss) share available to common stockholders/members follows:

	Three Ended March 31,	
	2014	**2013**
Basic	35,027,480	33,398,797
Stock options and employee stock purchase plan shares	705,980	442,258
Unvested restricted stock awards	105,393	10,788
Diluted	35,838,853	33,851,843

Recently Issued Accounting Standard Updates

None of the recently issued accounting standard updates is expected to have a material impact.

(2) Short Term Investments and Fair Value Measurements

Short term investments are summarized as follows:

As of March 31, 2014				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Market Value
Commercial Paper	$ 54,997	$	$ (3)	$ 54,994
Total	$ 54,997	$	$ (3)	$ 54,994

As of December 31, 2013				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Market Value
Commercial Paper	$ 54,431	$	$ (2)	$ 54,429
Total	$ 54,431	$	$ (2)	$ 54,429

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The following table represents the Company s fair value hierarchy for its financial assets:

	As of March 31, 2014							
	Aggregate Fair Value		Level 1		Level 2		Level 3	
Commercial Paper	$	54,994	$		$	54,994	$	
Total	$	54,994	$		$	54,994	$	

	As of December 31, 2013							
	Aggregate Fair Value		Level 1		Level 2		Level 3	
Commercial Paper	$	54,429	$		$	54,429	$	
Total	$	54,429	$		$	54,429	$	

The Company s investments classified as level 2 are priced using quoted market prices for identical assets which are subject to infrequent transactions. Cash and cash equivalents, accounts receivable, restricted cash, accounts payable, accrued expenses and deferred revenue carrying amounts approximate fair value because of the short maturity of these instruments. The Company s non-financial assets, which include property and equipment, intangible assets and goodwill, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required and the Company is required to evaluate the non-financial asset for impairment, a resulting asset impairment would require that the non-financial asset be recorded at the fair value.

(3) Information About Revenue By Geographic Areas

The following represents our geographic revenue based on customer location:

	Three Months Ended March 31,			
	2014		2013	
North America	$	26,504	$	18,363
Europe		26,649		19,040
Rest of the world		19,624		13,714
Total revenue	$	72,777	$	51,117

Included in North America is the United States which comprises 32% of total revenue for three months ended March 31, 2014 and 2013. No other country accounts for more than 10% of the Company s revenue in any period. All long-lived assets are located in North America.

(4) Goodwill and Intangible Assets

The Company s goodwill balance is attributable to its Bigstockphoto, Inc. (Bigstock) and WebDAM reporting units and is tested for impairment at least annually on October 1 or upon a triggering event. The following table summarizes the changes in the Company s goodwill balance through March 31, 2014:

	Bigstock	WebDAM	Consolidated
Balance as of December 31, 2013	$ 1,423	$	$ 1,423
Goodwill related to acquisitions		8,763	8,763