CHANNELADVISOR CORP
Form 10-Q
August 09, 2018
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 June 30, 2018
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 001-35940

CHANNELADVISOR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	56-2257867
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3025 Carrington Mill Boulevard, Morrisville, NC	27560
(Address of principal executive offices)	(Zip Code)

(919) 228-4700
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Securities Exchange Act of 1934.

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

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

Exchange Act. x
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x
The number of outstanding shares of the registrant's common stock, par value $0.001 per share, as of the close of business on July 24, 2018 was 27,282,599.

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PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CHANNELADVISOR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	June 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 50,912	$ 53,422
Accounts receivable, net of allowance of $607 and $609 as of June 30, 2018 and December 31, 2017, respectively	21,210	27,452
Prepaid expenses and other current assets	14,384	16,462
Total current assets	86,506	97,336
Property and equipment, net	12,871	10,877
Goodwill	23,486	23,486
Intangible assets, net	2,198	2,503
Deferred contract costs, net of current portion	9,235	—
Long-term deferred tax assets, net	4,792	5,550
Other assets	1,342	759
Total assets	$ 140,430	$ 140,511
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 4,892	$ 7,243
Accrued expenses	12,022	12,611
Deferred revenue	26,023	27,143
Other current liabilities	4,410	4,477
Total current liabilities	47,347	51,474
Long-term capital leases, net of current portion	1,555	641
Lease incentive obligation	2,541	3,328
Other long-term liabilities	2,561	3,157
Total liabilities	54,004	58,600
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding as of June 30, 2018 and December 31, 2017	—	—
Common stock, $0.001 par value, 100,000,000 shares authorized, 27,278,649 and 26,601,626 shares issued and outstanding as of June 30, 2018 and December 31, 2017, respectively	27	27
Additional paid-in capital	266,222	262,805
Accumulated other comprehensive loss	(1,271)	(789)
Accumulated deficit	(178,552)	(180,132)
Total stockholders' equity	86,426	81,911
Total liabilities and stockholders' equity	$ 140,430	$ 140,511

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

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CHANNELADVISOR CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$32,660	$ 30,004	$64,105	$ 58,333
Cost of revenue (1)	6,975	7,144	14,328	14,840
Gross profit	25,685	22,860	49,777	43,493
Operating expenses:				
Sales and marketing (1)	15,974	15,003	30,864	30,188
Research and development	5,737	5,147	11,639	10,118
General and administrative	6,708	6,678	13,159	15,208
Total operating expenses	28,419	26,828	55,662	55,514
Loss from operations	(2,734)	(3,968)	(5,885)	(12,021)
Other income (expense):				
Interest income (expense), net	106	54	231	82
Other income (expense), net	(1)	13	(20)	70
Total other income (expense)	105	67	211	152
Loss before income taxes	(2,629)	(3,901)	(5,674)	(11,869)
Income tax expense	135	84	247	172
Net loss	$(2,764)	$ (3,985)	$(5,921)	$ (12,041)
Net loss per share:				
Basic and diluted	$(0.10)	$ (0.15)	$(0.22)	$ (0.46)
Weighted average common shares outstanding:				
Basic and diluted	27,180,435	26,380,031	26,961,102	26,219,348

(1) Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications had no impact on reported operating loss or net loss for the period. Refer to Note 2, "Significant Accounting Policies," for further detail.

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

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CHANNELADVISOR CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net loss	$(2,764)	$(3,985)	$(5,921)	$(12,041)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(591)	325	(482)	535
Total comprehensive loss	$(3,355)	$(3,660)	$(6,403)	$(11,506)

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

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CHANNELADVISOR CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Cash flows from operating activities		
Net loss	$(5,921)	$(12,041)
Adjustments to reconcile net loss to cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	2,959	3,436
Bad debt expense	532	113
Stock-based compensation expense	5,049	6,292
Deferred income taxes	190	155
Other items, net	(390)	(434)
Changes in assets and liabilities, net of effects from acquisition:		
Accounts receivable	5,550	(2,157)
Prepaid expenses and other assets	4,373	1,193
Deferred contract costs	(3,586)	—
Accounts payable and accrued expenses	(5,398)	276
Deferred revenue	(2,326)	3,070
Cash and cash equivalents provided by (used in) operating activities	1,032	(97)
Cash flows from investing activities		
Purchases of property and equipment	(656)	(543)
Payment of internal-use software development costs	(290)	(159)
Acquisition, net of cash acquired	—	(2,177)
Cash and cash equivalents used in investing activities	(946)	(2,879)
Cash flows from financing activities		
Repayment of capital leases	(1,837)	(2,439)
Proceeds from exercise of stock options	1,004	339
Payment of statutory tax withholding related to net-share settlement of restricted stock units	(1,569)	(2,494)
Cash and cash equivalents used in financing activities	(2,402)	(4,594)
Effect of currency exchange rate changes on cash and cash equivalents	(194)	29
Net decrease in cash and cash equivalents	(2,510)	(7,541)
Cash and cash equivalents, beginning of period	53,422	65,420
Cash and cash equivalents, end of period	$50,912	$57,879
Supplemental disclosure of cash flow information		
Cash paid for interest	$19	$93
Cash paid for income taxes, net	$58	$144
Supplemental disclosure of noncash investing and financing activities		
Accrued statutory tax withholding related to net-share settlement of restricted stock units	$1,067	$—
Accrued capital expenditures	$77	$557
Capital lease obligations entered into for the purchase of fixed assets	$4,217	$567

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

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CHANNELADVISOR CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF THE BUSINESS

ChannelAdvisor Corporation ("ChannelAdvisor" or the "Company") was incorporated in the state of Delaware and capitalized in June 2001. The Company began operations in July 2001. ChannelAdvisor is a provider of software-as-a-service, or SaaS, solutions and its mission is to connect and optimize the world's commerce. ChannelAdvisor's e-commerce cloud platform helps retailers and brands worldwide improve their online performance by expanding sales channels, connecting with consumers around the world, optimizing their operations for peak performance and providing actionable analytics to improve competitiveness. The Company is headquartered in Morrisville, North Carolina and maintains sales, service, support and research and development offices in various domestic and international locations. Please refer to the Company's website at www.channeladvisor.com for a complete list of its domestic and international office locations.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Interim Condensed Consolidated Financial Information

The accompanying condensed consolidated financial statements and footnotes have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") as contained in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") for interim financial information. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of financial position, the results of operations, comprehensive loss and cash flows. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited interim financial statements should be read in conjunction with the audited financial statements and related footnotes for the year ended December 31, 2017 ("fiscal 2017"), which are included in the Company's Annual Report on Form 10-K for fiscal 2017. Except for the adoption of Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts from Customers (Topic 606) ("ASC 606"), there have been no material changes to the Company's significant accounting policies from those described in the footnotes to the audited financial statements contained in the Company's Annual Report on Form 10-K for fiscal 2017. Refer to Note 6, "Revenue from Contracts with Customers" for a description of changes to the Company's revenue recognition and contract costs accounting policies as a result of the adoption of ASC 606.

Reclassification

Certain prior period amounts included in the unaudited condensed consolidated statements of operations have been reclassified to conform to the current period's presentation. The Company has revised the classification of certain employee-related and other operating expenses to better align the income statement line items with departmental responsibilities and the management of operations. These reclassifications had no effect on the Company's reported operating loss or net loss for the three and six months ended June 30, 2017.

The table below summarizes the financial statement line items impacted by these reclassifications (in thousands):

	Three Months Ended June 30, 2017		
	As Previously Reported	Reclassification	As Reclassified
Cost of revenue	$6,520	$ 624	$ 7,144
Gross profit	23,484	(624)	22,860
Sales and marketing	15,627	(624)	15,003
Total operating expenses	27,452	(624)	26,828

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	Six Months Ended June 30, 2017		
	As Previously Reported	Reclassification	As Reclassified
Cost of revenue	$13,362	$ 1,478	$ 14,840
Gross profit	44,971	(1,478)	43,493
Sales and marketing	31,666	(1,478)	30,188
Total operating expenses	56,992	(1,478)	55,514

Recent Accounting Pronouncements

Standard	Description	Effect on the Financial Statements or Other Significant Matters
Standards that the Company has not yet adopted		
Leases:		
ASU 2016-02, Leases (Topic 842) Effective date: January 1, 2019	This standard requires that lessees recognize assets and liabilities for leases with lease terms greater than twelve months in the statement of financial position. This standard also requires improved disclosures to help users of financial statements better understand the amount, timing and uncertainty of cash flows arising from leases.	The Company formed a project team and developed a plan to prepare for the adoption of this standard by its effective date. The project team has performed a business impact assessment, has identified a population of leases and has performed an analysis on its lease population using an expected incremental borrowing rate to assess its adoption of the ASU. The project team has assessed service agreements for potentially embedded leases and has identified leases it considers short term in duration. Based upon the project team's analysis, the Company expects to elect the package of three practical expedients, as well as the practical expedient to apply hindsight in determining lease terms. The Company continues to evaluate transition methods and the impact that ASU 2016-02 will have on internal controls over financial reporting and its consolidated financial statements.
Financial Instruments:		
ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) Effective date: January 1, 2020	This standard replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses. The update is intended to provide financial statement users with more useful information about expected credit losses.	The Company is currently evaluating the impact the adoption of this standard will have on its consolidated financial statements.

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Standard	Description	Effect on the Financial Statements or Other Significant Matters
Standards that the Company has recently adopted		
Cash Flow:		
ASU 2016-18, Restricted Cash	This standard requires that entities show the changes in the total of cash, cash equivalents and restricted cash in the statement of cash flows. Transfers between cash, cash equivalents and restricted cash should not be presented as cash flow activities on the statement of cash flows.	The Company adopted this standard effective January 1, 2018. The adoption did not have a material impact on its consolidated financial statements.
Revenue Recognition:		
ASU 2014-09, Revenue from Contracts with Customers (Topic 606)	This standard replaces existing revenue recognition standards and provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires enhanced disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. Entities have the option of using either a full retrospective or modified retrospective approach for the adoption of the standard.	The Company adopted this standard effective January 1, 2018 using the modified retrospective transition method. Refer to Note 6, "Revenue from Contracts with Customers," for additional information regarding the impact of adoption and revenue recognition under ASC 606 on the Company's consolidated financial statements.

The Company has reviewed new accounting pronouncements that were issued during the six months ended June 30, 2018 and does not believe that these pronouncements are applicable to the Company, or that they will have a material impact on its financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, the useful lives of long-lived assets and other intangible assets, income taxes, assumptions used for purposes of determining stock-based compensation, and revenue recognition, including standalone selling prices for contracts with multiple performance obligations and the expected period of benefit for deferred contract costs, among others. Estimates and assumptions are also required to value assets acquired and liabilities assumed in conjunction with business combinations. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable, the results of which form the basis for making judgments about the carrying value of assets and liabilities.

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3. STOCKHOLDERS' EQUITY

The following table summarizes the stockholders' equity activity for the six months ended June 30, 2018 (in thousands):

Balance as of December 31, 2017	$81,911
Cumulative effect of accounting change (1)	7,501
Exercise of stock options and vesting of restricted stock units	1,004
Stock-based compensation expense	5,049
Statutory tax withholding related to net-share settlement of restricted stock units	(2,636)
Net loss	(5,921)
Foreign currency translation adjustments	(482)
Balance as of June 30, 2018	$86,426

(1) Refer to Note 6, "Revenue from Contracts with Customers," for additional information regarding the effect of the adoption of ASC 606 and adjustments to accumulated deficit upon adoption.

4. GOODWILL AND INTANGIBLE ASSETS

The Company has acquired intangible assets in connection with its business acquisitions. These assets were recorded at their estimated fair values at the acquisition date and are being amortized over their respective estimated useful lives using the straight-line method. The estimated useful lives and amortization methodology used in computing amortization are as follows:

	Estimated Useful Life	Amortization Methodology
Customer relationships	7 years	Straight-line
Acquired technology	7 years	Straight-line

Amortization expense associated with the Company's intangible assets was $0.2 million for each of the three months ended June 30, 2018 and 2017, and $0.3 million for each of the six months ended June 30, 2018 and 2017.

There were no changes to the Company's goodwill during the six months ended June 30, 2018.

5. COMMITMENTS

Sales Tax

During the first quarter of 2017, the Company completed its analysis with regard to potential unpaid sales tax obligations. Based on the results of this analysis, the Company made the decision to enter into voluntary disclosure agreements ("VDAs") with certain jurisdictions to reduce the Company's potential sales tax liability. VDAs generally provide for a maximum look-back period, a waiver of penalties and, at times, interest as well as payment arrangements. The Company's estimated aggregate VDA liability of $2.5 million was recorded as a one-time charge in general and administrative expense in the accompanying condensed consolidated statements of operations for the six months ended June 30, 2017. This amount represented the Company's estimate of its potential unpaid sales tax liability through the anticipated look-back periods including interest, where applicable, in all jurisdictions in which the Company has entered into VDAs. During the third quarter of 2017, one jurisdiction rejected the Company's VDA application and conducted a sales tax audit, which was completed in May 2018.

Through June 30, 2018, the Company has paid an aggregate of $2.5 million under the terms of the VDA agreements and to settle the sales tax audit. The Company has no other unresolved VDA applications or ongoing sales tax audits as of June 30, 2018.

6. REVENUE FROM CONTRACTS WITH CUSTOMERS

Financial Statement Impact of Adopting ASC 606, "Revenue from Contracts with Customers"

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective transition method and applied this method to all contracts that were not complete as of the date of adoption. The reported results as of June 30, 2018 and for the three and six months ended June 30, 2018 in the accompanying unaudited condensed consolidated financial statements are presented under ASC 606, while prior period results have not been adjusted and are reported in accordance with historical accounting guidance in effect for those periods.

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The most significant impacts of this standard relate to the timing of revenue recognition of fixed fees under the Company’s contracts, as well as the accounting for costs to obtain contracts. Under ASC 606, for the Company's managed-service contracts, revenue recognition for subscription and implementation fees begins on the launch date and is recognized over time through the term of the contract. Before the adoption of this standard, the Company deferred the recognition of revenue until the completion of the implementation services, at which point the Company recognized a cumulative catch-up adjustment equal to the revenue earned during the implementation period that had been deferred. The Company then recognized the remaining balance of the fixed fees ratably over the remaining term of the contract. Additionally, under ASC 606, the Company now defers recognition of expense for sales commissions and a portion of other incentive compensation ("contract costs"). These contract costs are amortized to expense over the expected period of benefit. Before the adoption of ASC 606, the Company expensed these contract costs as incurred.

The adoption of ASC 606 under the modified retrospective transition method resulted in a net adjustment reducing the accumulated deficit by $7.5 million at January 1, 2018. The adjustment consisted of $8.7 million related to the deferral of contract costs that were historically expensed as incurred, $(0.6) million related to the timing of revenue recognition for managed-service contracts, and $(0.6) million related to the tax impact of the contract costs and revenue adjustments.

Revenue Recognition

In accordance with ASC 606, revenue is recognized when a customer obtains control of promised services, in an amount that reflects the consideration the Company expects to be entitled to receive in exchange for those services. In determining the amount of revenue to be recognized, the Company performs the following steps: (i) identification of the contract with a customer; (ii) identification of the promised services in the contract and determination of whether the promised services are performance obligations, including whether they are distinct in the context of the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price to the performance obligations based on estimated selling prices; and (v) recognition of revenue when (or as) the Company satisfies each performance obligation.

Disaggregation of Revenue

The Company derives the majority of its revenue from subscription fees paid for access to and usage of its SaaS solutions for a specified period of time, typically one year. A portion of the subscription fee is typically fixed and is based on a specified minimum amount of gross merchandise value ("GMV") or advertising spend that a customer expects to process through the Company's platform over the contract term. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV or advertising spend processed through the Company's platform in excess of the customer's specified minimum GMV or advertising spend amount. In addition to subscription fees, contracts with customers may include implementation fees for launch assistance and training. Fixed subscription and implementation fees are billed in advance of the subscription term and are due in accordance with contract terms, which generally provide for payment within 30 days. Variable fees are subject to the same payment terms, although they are generally billed the month after they are incurred. The Company also generates revenue from its solutions that allow brands to direct potential consumers from their websites and digital marketing campaigns to authorized resellers. These contracts are generally one year in duration. The Company’s contractual arrangements include performance, termination and cancellation provisions, but do not provide for refunds. Customers do not have the contractual right to take possession of the Company’s software at any time. Sales taxes collected from customers and remitted to government authorities are excluded from revenue.

The following table summarizes revenue disaggregation by product for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017 (1)	2018	2017 (1)
Marketplaces	$23,811	$22,972	$47,799	$45,061
Digital Marketing	4,505	4,321	8,850	8,518

Other	4,344	2,711	7,456	4,754
	$32,660	$30,004	$64,105	$58,333

(1) As noted above, prior periods have not been adjusted for the adoption of ASC 606 and are presented in accordance with historical accounting guidance in effect for those periods.

Marketplaces and Digital Marketing - The Company's Marketplaces module connects customers to third-party e-commerce marketplaces and provides access to advertising programs and advanced competitive features on major marketplaces. The Company's Digital Marketing module allows customers to create and optimize advertisements on multiple online shopping channels. Customers may subscribe to each of these modules on a self-service or managed-service basis. Self-service subsc

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riptions allow the customer to manage their own activity on the platform. Launch services are also available, although they are not required for the customer to access the platform. Revenue from self-service subscriptions, including fixed subscription fees and fees associated with any elected launch services, is recognized ratably over the subscription term, which is typically one year, beginning on the date the customer has access to the platform. Managed-service subscriptions offer the customer an outsourced, managed platform experience. Implementation services are included with managed-service subscriptions and are necessary to launch on the platform. Revenue from managed-service subscriptions, including fixed subscription fees and fees associated with implementation services, is recognized ratably over the subscription term, which is typically one year, beginning once implementation services are complete. As noted above, customers incur variable fees when the GMV processed through Marketplaces, or the GMV or advertising spend processed through Digital Marketing, exceeds the GMV or advertising spend included in their subscriptions. In general, revenue from variable fees is recognized in the period in which the related GMV or advertising spend is processed through the platform.

Other - Other product offerings include the Company's Where to Buy and Product Intelligence solutions, which provide current information on resellers and product availability and insights on product assortment, gaps, and pricing trends. These solutions are only available on a managed-service basis and include implementation services. The Company also enters into integration agreements with certain marketplaces or channels under which the partner engages the Company to integrate the platform with their marketplace or channel. Revenue from these product offerings is recognized ratably over the subscription term beginning on the date the implementation or integration is complete.

Contracts with Multiple Performance Obligations

Customers may elect to purchase a subscription to multiple modules, multiple modules with multiple service levels, or, for certain of the Company's solutions, multiple brands or geographies. The Company evaluates such contracts to determine whether the services to be provided are distinct and accordingly, should be accounted for as separate performance obligations. If the Company determines that a contract has multiple performance obligations, the transaction price, which is the total price of the contract, is allocated to each performance obligation based on a relative standalone selling price method. The Company estimates standalone selling price based on observable prices in past transactions for which the product offering subject to the performance obligation has been sold separately. As the performance obligations are satisfied, revenue is recognized as discussed above in the product descriptions.

Transaction Price Allocated to Future Performance Obligations

ASC 606 provides certain practical expedients that limit the required disclosure of the aggregate amount of transaction price that is allocated to performance obligations that have not yet been satisfied. As the Company typically enters into contracts with customers for a twelve-month subscription term, substantially all of its performance obligations that have not yet been satisfied as of June 30, 2018 are part of a contract that has an original expected duration of one year or less. For contracts with an original expected duration of greater than one year, for which the practical expedient does not apply, the aggregate transaction price allocated to the unsatisfied performance obligations was $21.9 million as of June 30, 2018, of which $13.7 million is expected to be recognized as revenue over the next twelve months.

Deferred Revenue

Deferred revenue represents the unearned portion of subscription and implementation fees. Deferred revenue is recorded when cash payments are received in advance of performance. Deferred amounts are generally recognized within one year. Deferred revenue is included in the accompanying condensed consolidated balance sheets under "Total current liabilities," net of any long-term portion that is included in "Other long-term liabilities." The following table summarizes deferred revenue activity for the six months ended June 30, 2018 (in thousands):

	As of January 1, 2018 (adjusted)	Net Additions	Revenue recognized	As of June 30, 2018
Deferred revenue	$ 28,982	61,470	(64,105)	$ 26,347

Of the $64.1 million of revenue recognized in the six months ended June 30, 2018, $20.5 million was included in deferred revenue at January 1, 2018.

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Costs to Obtain Contracts

In accordance with ASC 606, the Company now capitalizes sales commissions and a portion of other incentive compensation costs that are directly related to obtaining customer contracts and that would not have been incurred if the contract had not been obtained. These costs are included in the accompanying condensed consolidated balance sheets and are classified as "Prepaid expenses and other current assets," net of any long-term portion that is included in "Deferred contract costs, net of current portion." Deferred contract costs are amortized to sales and marketing expense over the expected period of benefit, which the Company has determined to be five years based on the estimated customer relationship period. The following table summarizes deferred contract cost activity for the six months ended June 30, 2018 (in thousands):

	As of January 1, 2018 (adjusted)	Additions	Amortized costs (1)	As of June 30, 2018
Deferred contract costs	$ 8,721	4,882	(1,445)	$12,158

(1) Includes contract costs amortized to sales and marketing expense during the period and the impact from foreign currency exchange rate fluctuations.

Financial Statement Impact

The following tables compare financial statement line items from the reported condensed consolidated balance sheet, condensed consolidated statement of operations and condensed consolidated statement of cash flows, as of and for the three and six months ended June 30, 2018, to the pro forma amounts, which are the amounts that would have been reported prior to the adoption of ASC 606 (in thousands):

Balance Sheet - select financial statement line items impacted by the adoption of ASC 606	As of June 30, 2018	
	As Reported	Pro Forma
Prepaid expenses and other current assets	$14,384	$11,461
Total current assets	86,506	83,583
Deferred contract costs, net of current portion	9,235	—
Long-term deferred tax assets, net	4,792	5,450
Total assets	140,430	128,930
Deferred revenue	26,023	25,652
Total current liabilities	47,347	46,976
Other long-term liabilities	2,561	2,447
Total liabilities	54,004	53,519
Accumulated other comprehensive loss	(1,271)	(1,091)
Accumulated deficit	(178,552)	(189,747)
Total liabilities and stockholders' equity	$140,430	$128,930

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Statement of Operations - select financial statement line items impacted by the adoption of ASC 606	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	As Reported	Pro Forma	As Reported	Pro Forma
Revenue	$32,660	$32,362	$64,105	$63,774
Gross profit	25,685	25,387	49,777	49,446
Sales and marketing	15,974	17,469	30,864	34,301
Total operating expenses	28,419	29,914	55,662	59,099
Loss from operations	(2,734)	(4,527)	(5,885)	(9,653)
Other income (expense), net	(1)	(150)	(20)	(169)
Total other income (expense)	105	(44)	211	62
Loss before income taxes	(2,629)	(4,571)	(5,674)	(9,591)
Income tax expense	135	13	247	24
Net loss	(2,764)	(4,584)	(5,921)	(9,615)
Net loss per share, basic and diluted	$(0.10)	$(0.17)	$(0.22)	$(0.36)

Statement of Cash Flows - select financial statement line items impacted by the adoption of ASC 606	Six Months Ended June 30, 2018	
	As Reported	Pro Forma
Net loss	$(5,921)	$(9,615)
Deferred income taxes	190	(33)
Changes in assets and liabilities:		
Deferred contract costs	(3,586)	—
Deferred revenue	(2,326)	(1,995)
Cash and cash equivalents provided by operating activities	$1,032	$1,032

7. STOCK-BASED COMPENSATION

The Company recognizes stock-based compensation expense using the accelerated attribution method, net of estimated forfeitures, in which compensation cost for each vesting tranche in an award is recognized ratably from the service inception date to the vesting date for that tranche.

Stock-based compensation expense is included in the following line items in the accompanying condensed consolidated statements of operations for the three and six months ended June 30, 2018 and 2017 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of revenue (1)	$92	$239	$309	$566
Sales and marketing (1)	728	1,172	1,480	1,918
Research and development	355	503	1,004	1,071
General and administrative	1,141	1,454	2,256	2,737
	$2,316	$3,368	$5,049	$6,292

(1) Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications had no impact on the Company's reported operating loss or net loss for the period. Refer to Note 2, "Significant Accounting Policies," for further detail.

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During the six months ended June 30, 2018, the Company granted the following share-based awards:

	Number of Shares Underlying Grant	Weighted Average Grant Date Fair Value
Stock options	362,415	$ 5.98
Restricted stock units ("RSUs")	866,121	$ 13.95
Total share-based awards	1,228,536	$ 11.60

8. NET LOSS PER SHARE

Diluted net loss per share is the same as basic net loss per share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company's net loss. The following securities have been excluded from the calculation of weighted average common shares outstanding because the effect is anti-dilutive for the three and six months ended June 30, 2018 and 2017:

	Three and Six Months Ended June 30,	
	2018	2017
Stock options	2,307,949	2,196,719
RSUs	2,333,294	2,616,117

9. INCOME TAXES

At the end of each interim reporting period, the Company estimates its effective income tax rate expected to be applicable for the full year. This estimate is used to determine the income tax provision or benefit on a year-to-date basis and may change in subsequent interim periods.

The Company's effective tax rate was (5.1)% and (2.2)% for the three months ended June 30, 2018 and 2017, respectively, and (4.4)% and (1.4)% for the six months ended June 30, 2018 and 2017, respectively. The tax expense for each of the periods was based on state, local and foreign taxes. The Company’s effective tax rate for these periods is lower than the U.S. federal statutory rate of 21% for the three and six months ended June 30, 2018 and 34% for the three and six months ended June 30, 2017 primarily due to operating losses which are subject to a valuation allowance. The Company cannot recognize the tax benefit of operating loss carryforwards generated in certain jurisdictions due to uncertainties relating to future taxable income in those jurisdictions in terms of both its timing and its sufficiency, which would enable the Company to realize the benefits of those carryforwards. The change in the effective tax rate for the three and six months ended June 30, 2018 compared with the same periods in the prior year is primarily due to the Company's adoption of ASC 606 which resulted in increased income in certain of the Company's foreign subsidiaries.

The Tax Cuts and Jobs Act of 2017 ("Tax Act"), which went into effect on December 22, 2017, significantly revises the Internal Revenue Code of 1986, as amended ("IRC"). The Tax Act is complex and it will take time to assess the implications thoroughly. The Company is currently evaluating the Tax Act with its professional advisors and has included the effects of the following changes enacted in the Tax Act in this report:

•For the financial statements included in the Company's Annual Report on Form 10-K for fiscal 2017, the Company reduced its expected U.S. federal corporate income tax rate used to measure its deferred tax assets and liabilities to the newly enacted rate of 21% from 34%, which had been used in the calculation of the Company's income tax expense for the three and six months ended June 30, 2017. The U.S. federal corporate income tax rate of 21% was used in the calculation of the Company's income tax expense for the three and six months ended June 30, 2018.

•The Company incorporated the newly enacted rules in the Tax Act relating to net operating loss carryforwards. The new rules allow for an indefinite carryforward of unused net operating losses generated in years ending after December 31, 2017. The Company does not generally consider deferred tax liabilities on indefinite-lived assets as a source of future taxable income available to be able to realize deferred tax assets. However, the Company considers the deferred tax liability associated with the indefinite-lived intangible asset as a source of future taxable income available to realize the benefit of deferred tax assets recorded for indefinite-lived tax attributes. For net operating losses generated in periods starting after December 31, 2017, the Company has begun to record the tax benefit of the deferred tax asset up to the amount of the deferred tax liability on the indefinite-lived asset. This resulted in a $0.1 million reduction in the Company's income tax expense for the six months ended June 30, 2018. Any amount of the deferred tax asset record

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ed in excess of the deferred tax liability is expected to be offset by a valuation allowance.

Other provisions of the Tax Act might have a significant impact on the Company, such as the repeal of the alternative minimum tax, the new requirement to capitalize research and experimentation expenses, and the creation of the base erosion anti-abuse tax, the global intangible low taxed income inclusion and the foreign derived intangible income deduction. However, based on its current estimates, the Company does not expect that these or the other changes enacted as part of the Tax Act will have a material impact on its financial results as of and for the year ending December 31, 2018. However, new developments such as changes in the Company’s operations or the issuance of additional guidance from the Internal Revenue Service ("IRS") could result in changes to the Company’s analysis and estimates. In addition, it is uncertain if and to what extent various states will conform to the Tax Act.

On December 22, 2017, SEC Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of U.S. GAAP in situations in which a registrant does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. In accordance with SAB 118, the Company reduced its net deferred tax assets by $16.6 million to account for the decrease in the U.S. federal tax rate, made a de minimis reduction in its end of year deferred tax asset to account for the changes to IRC Section 162(m), and included a reasonable estimate of the impact of revenue recognition in conjunction with the new IRC Section 451(c); such adjustments were provisional and reflect the Company's reasonable estimates at December 31, 2017 and June 30, 2018. Additional work is necessary for a more detailed analysis of the impacts of the Tax Act. Any subsequent adjustment to these amounts will be recorded to current tax expense in the quarter of 2018 in which the analysis is complete.

10. SEGMENT AND GEOGRAPHIC INFORMATION

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker ("CODM") for purposes of allocating resources and evaluating financial performance. The Company’s CODM reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, the Company’s operations constitute a single operating segment and one reportable segment.

Substantially all assets were held in the United States during the six months ended June 30, 2018 and the year ended December 31, 2017. The table below summarizes revenue by geography for the three and six months ended June 30, 2018 and 2017 (in thousands). The Company categorizes domestic and international revenue from customers based on their billing address.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Domestic	$25,076	$23,691	$49,537	$46,198
International	7,584	6,313	14,568	12,135
Total revenue	$32,660	$30,004	$64,105	$58,333

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

Certain statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," or similar expressions, or the negative of such words or phrases, are intended to identify "forward-looking statements." We have based these forward-looking statements on our current expectations and projections about future events. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. These forward-looking statements are based upon information available to us as of the date of this Quarterly Report, and while we believe such information forms a reasonable basis for such statements, such information may be limited or incomplete, and our statements should not be read to indicate that we have conducted an exhaustive inquiry into, or review of, all potentially available relevant information. These statements are inherently uncertain and investors are cautioned not to unduly rely upon these statements. Factors that could cause or contribute to these differences include those below and elsewhere in this Quarterly Report on Form 10-Q, particularly in Part II – Item 1A, "Risk Factors," and our other filings with the Securities and Exchange Commission. Statements made herein are as of the date of the filing of this Form 10-Q with the Securities and Exchange Commission and should not be relied upon as of any subsequent date. Unless otherwise required by applicable law, we do not undertake, and we specifically disclaim, any obligation to update any forward-looking statements to reflect occurrences, developments, unanticipated events or circumstances after the date of such statement.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes that appear in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and related notes for the year ended December 31, 2017, which are included in our Annual Report on Form 10-K for fiscal 2017.

We are a leading provider of software-as-a-service, or SaaS, solutions and our mission is to connect and optimize the world's commerce. Our e-commerce cloud platform helps retailers and brands worldwide improve their online performance by expanding sales channels, connecting with consumers around the world, optimizing their operations for peak performance and providing actionable analytics to improve competitiveness. Our customers include the online businesses of traditional retailers, online retailers and brands, as well as advertising agencies that use our solutions on behalf of their clients. Through our platform, we enable our customers to connect with new and existing sources of demand for their products through channels such as Amazon, eBay, Facebook, Google and Walmart. Our fulfillment solution makes it easier for customers to connect to their supply chain, which could include distributors, manufacturers and third-party logistic providers. Our suite of solutions, accessed through a standard web browser, provides our customers with a single, integrated user interface to manage their product listings, inventory availability, pricing optimization, search terms, orders and fulfillment, as well as data analytics and other critical functions across these channels. We also offer solutions that allow brands to send their web visitors or digital marketing audiences directly to authorized resellers and to gain insight into consumer behavior. Our proprietary cloud-based technology platform delivers significant breadth, scalability and flexibility.

EXECUTIVE OVERVIEW

FINANCIAL RESULTS

- Total revenue of $32.7 million and $64.1 million for the three and six months ended June 30, 2018 increased 8.9% and 9.9%, respectively, from the comparable prior year periods;
- Average revenue per customer of $45,029 for the twelve months ended June 30, 2018 increased 9.7% compared with $41,029 for the twelve months ended June 30, 2017;
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- Revenue was comprised of 75.8% and 24.2% fixed and variable subscription fees, respectively, for the three months ended June 30, 2018 compared with fixed and variable subscription fees of 75.3% and 24.7%, respectively, for the three months ended June 30, 2017;
- Revenue was comprised of 76.0% and 24.0% fixed and variable subscription fees, respectively, for the six months ended June 30, 2018 compared with fixed and variable subscription fees of 76.6% and 23.4%, respectively, for the six months ended June 30, 2017;

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- Revenue derived from customers located outside of the United States as a percentage of total revenue was 23.2% and 22.7% for the three and six months ended June 30, 2018, respectively, compared with 21.0% and 20.8%, respectively, for the comparable prior year periods;
- Gross margin of 78.6% and 77.6% for the three and six months ended June 30, 2018, respectively, improved by 240 and 300 basis points, respectively, from the comparable prior year periods;
- Operating margin of (8.4)% and (9.2)% for the three and six months ended June 30, 2018, respectively, improved by 480 and 1,140 basis points, respectively, from the comparable prior year periods;
- Net loss of $(2.8) million and $(5.9) million for the three and six months ended June 30, 2018, respectively, improved compared to net loss of $(4.0) million and $(12.0) million, respectively, for the comparable prior year periods;
- Adjusted EBITDA was $1.1 million and $2.1 million for the three and six months ended June 30, 2018, respectively, compared to adjusted EBITDA of $1.1 million and $0.3 million, respectively, for the comparable prior year periods;
- Cash and cash equivalents was $50.9 million at June 30, 2018 compared with $53.4 million at December 31, 2017; and
- Operating cash flow was $1.0 million for the six months ended June 30, 2018 compared to $(0.1) million for the six months ended June 30, 2017.

TRENDS IN OUR BUSINESS

The following trends have contributed to the results of our consolidated operations, and we anticipate that they will continue to impact our future results:

- Growth in Online Shopping. Consumers continue to move more of their retail spending from offline to online retail. The continuing shift to online shopping and overall growth has contributed to our historical growth and we expect that this online shift will continue to benefit our business.
- Product Offering Expansion. As online shopping evolves, we continue to expand our product offerings to reflect the needs of companies seeking to attract consumers. In 2017, we expanded our research and development capabilities with new talent through organic growth, an acquisition and expanding our operations overseas with the opening of a new research and development facility in Madrid, Spain. In 2018, we continued to enhance our product offering by increasing online shopping marketplace channel integrations including first party retail programs and improving our analytics capabilities and fulfillment feature set.
- Growth in Mobile Usage. We believe the shift toward mobile commerce will increasingly favor aggregators such as Amazon, eBay and Google, all of which are focal points of our platform. These systems understand the identity of the buyer, helping to reduce friction in the mobile commerce process, while offering a wide selection of merchandise in a single location. The growth in mobile commerce may result in increased revenue for us.
- Shift to Larger Customers. We believe that the growth in online shopping increasingly favors larger enterprises. This move impacts our business both in longer sales cycles as well as increased average revenue per customer.
- Evolving Fulfillment Landscape. Consumers have been conditioned to expect fast, efficient delivery of products. We believe that determining and executing on a strategy to more expeditiously receive, process and deliver online orders, which we refer to collectively as fulfillment, is critical to success for online sellers. Therefore, it will be increasingly important for us to facilitate and optimize fulfillment services on behalf of our customers, which in turn may result in additional research and development investment. We believe our strategic acquisition of a fulfillment platform in 2017 will continue to further enhance our fulfillment offering and strategy.
- Focus on Employees. We strive to provide competitive compensation and benefits programs to help attract and retain quality employees who are focused on facilitating the success of our customers. We increased headcount by 5.4% from June 30, 2017 to June 30, 2018 to help drive revenue growth and support our overall operations.
- Seasonality. Our revenue fluctuates as a result of seasonal variations in our business, principally due to the peak consumer demand and related increased volume of our customers’ gross merchandise value, or GMV, during the year-end holiday season. As a result, we have historically had higher revenue in our fourth quarter than other quarters due to increased GMV processed through our platform, resulting in higher variable subscription fees.

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OPPORTUNITIES AND RISKS

- Dynamic E-commerce Landscape. We need to continue to innovate in the face of a rapidly changing e-commerce landscape if we are to remain competitive, and we need to effectively manage our growth, especially related to our international expansion.
- Retailers and Brands. As consumer preferences potentially shift away from smaller retailers, we need to continue to add large retailers and brands as profitable customers. These customers generally pay a lower percentage of GMV as fees to us based on the relatively higher volume of their GMV processed through our platform. To help drive our future growth, we have made significant investments in our sales force and allocated resources focused on growing our customer base of large retailers and brands. We continue to focus our efforts on increasing value for our customers to support higher rates.
- Strategic Partnerships. Our business development team's mission is to expand our sales and market opportunities through strategic partner relationships. We plan to continue to invest in initiatives to expand our strategic partnership base to further enhance our offerings for retailers and brands.
- Increasing Complexity of E-commerce. Although e-commerce continues to expand as retailers and brands continue to increase their online sales, it is also becoming more complex due to the hundreds of channels available to retailers and brands and the rapid pace of change and innovation across those channels. In order to gain consumers' attention in a more crowded and competitive online marketplace, many retailers and an increasing number of brands sell their merchandise through multiple online channels, each with its own rules, requirements and specifications. In particular, third-party marketplaces are an increasingly important driver of growth for a number of large online retailers and brands. As a result, we need to continue to support multiple channels in a variety of geographies in order to support our targeted revenue growth. As of June 30, 2018, we supported over