

BLACKBAUD INC  
Form 10-Q  
August 06, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 000-50600

Blackbaud, Inc.  
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization) 2000 Daniel Island Drive Charleston, South Carolina 29492 (Address of principal executive offices, including zip code) (843) 216-6200 (Registrant's telephone number, including area code)	11-2617163 (I.R.S. Employer Identification No.)
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

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

YES  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  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

The number of shares of the registrant's Common Stock outstanding as of July 27, 2015 was 46,873,681.

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Blackbaud, Inc.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains “forward-looking statements” that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These statements are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements in this report not dealing with historical results or current facts are forward-looking and are based on estimates, assumptions and projections. Statements which include the words “believes,” “seeks,” “expects,” “may,” “might,” “should,” “intends,” “could,” “would,” “likely,” “will,” “targets,” “pursues,” “aims,” “projects,” “estimates” or the negative version of those words and similar statements of a future or forward-looking nature identify forward-looking statements.

Although we attempt to be accurate in making these forward-looking statements, future circumstances might differ from the assumptions on which such statements are based. In addition, other important factors that could cause results to differ materially include those set forth elsewhere in this report, under “Item 1A. Risk factors” and elsewhere in our Annual Report on Form 10-K for the year ended December 31, 2014 and in our other SEC filings. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

Blackbaud, Inc.

Consolidated balance sheets

(Unaudited)

(in thousands, except share amounts)	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$13,227	\$14,735
Donor restricted cash	61,055	140,709
Accounts receivable, net of allowance of \$4,433 and \$4,539 at June 30, 2015 and December 31, 2014, respectively	87,462	77,523
Prepaid expenses and other current assets	41,628	40,392
Deferred tax asset, current portion	11,967	14,423
Total current assets	215,339	287,782
Property and equipment, net	48,960	50,402
Goodwill	345,873	349,008
Intangible assets, net	212,596	229,307
Other assets	32,592	26,684
Total assets	\$855,360	\$943,183
Liabilities and stockholders' equity		
Current liabilities:		
Trade accounts payable	\$18,100	\$11,436
Accrued expenses and other current liabilities	45,357	52,201
Donations payable	61,055	140,709
Debt, current portion	4,375	4,375
Deferred revenue, current portion	225,076	212,283
Total current liabilities	353,963	421,004
Debt, net of current portion	253,130	276,196
Deferred tax liability	37,469	43,639
Deferred revenue, net of current portion	8,796	8,991
Other liabilities	6,747	7,437
Total liabilities	660,105	757,267
Commitments and contingencies (see Note 12)		
Stockholders' equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, \$0.001 par value; 180,000,000 shares authorized, 56,658,529 and 56,048,135 shares issued at June 30, 2015 and December 31, 2014, respectively	57	56
Additional paid-in capital	257,996	245,674
Treasury stock, at cost; 9,790,192 and 9,740,054 shares at June 30, 2015 and December 31, 2014, respectively	(192,665)	(190,440)
Accumulated other comprehensive loss	(1,926)	(1,032)
Retained earnings	131,793	131,658
Total stockholders' equity	195,255	185,916
Total liabilities and stockholders' equity	\$855,360	\$943,183

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



Blackbaud, Inc.  
 Consolidated statements of comprehensive income  
 (Unaudited)

(in thousands, except share and per share amounts)	Three months ended		Six months ended	
	June 30, 2015	2014	June 30, 2015	2014
Revenue				
Subscriptions	\$80,009	\$64,985	\$152,522	\$123,253
Maintenance	38,627	36,527	77,523	72,179
Services	33,667	31,795	64,973	59,925
License fees and other	3,956	6,081	8,234	11,653
Total revenue	156,259	139,388	303,252	267,010
Cost of revenue				
Cost of subscriptions	39,400	31,749	75,578	61,873
Cost of maintenance	6,969	5,983	14,471	11,397
Cost of services	25,915	25,540	52,886	51,803
Cost of license fees and other	1,146	1,424	2,307	2,953
Total cost of revenue	73,430	64,696	145,242	128,026
Gross profit	82,829	74,692	158,010	138,984
Operating expenses				

The notes will not be listed on any securities exchange. In the original offering of the notes, the notes will be sold in minimum investment amounts of 100 units. If you place an order to purchase the notes, you are consenting to MLPF&S acting as a principal in effecting the transaction for your account.

MLPF&S has advised us that it or its

affiliates may repurchase and resell the notes, with repurchases and resales being made at prices related to then-prevailing market prices or at negotiated prices determined by reference to their pricing models and at their discretion, and these prices will include MLPF&S's trading commissions and mark-ups. MLPF&S may act as principal or agent in these market-making transactions; however, it is not obligated to engage in any such transactions. MLPF&S has informed us that at MLPF&S's discretion, assuming no changes in market conditions from the pricing date, MLPF&S may offer to

buy the notes in the secondary market at a price that may exceed the initial estimated value of the notes for a short initial period after the issuance of the notes. Any price offered by MLPF&S for the notes is expected to be based on then-prevailing market conditions and other considerations, including the performance of the Index and the remaining term of the notes. However, none of us, MLPF&S, or any of our respective affiliates is obligated to purchase your notes at any price or at any time, and we cannot assure you that we, MLPF&S, or any of our respective affiliates will purchase your notes at a



price that equals or exceeds the initial estimated value of the notes.

MLPF&S has informed us that, as of the date of this term sheet, it expects that if you hold your notes in a MLPF&S account, the value of the notes shown on your account statement will be based on MLPF&S's estimate of the value of the notes if MLPF&S or another of its affiliates were to make a market in the notes, which it is not obligated to do; and that estimate will be based upon the price that MLPF&S may pay for the notes in light of then-prevailing market conditions, and other considerations, as mentioned above, and

will include transaction costs. Any such price may be higher than or lower than the initial estimated value of the notes.

The distribution of the Note Prospectus in connection with these offers or sales will be solely for the purpose of providing investors with the description of the terms of the notes that was made available to investors in connection with their initial offering. Secondary market investors should not, and will not be authorized to, rely on the Note Prospectus for information regarding Wells Fargo or for any purpose other than that described in the

immediately  
preceding  
sentence.

Leveraged TS-12  
Index  
Return  
Notes®

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Leveraged  
Index Return  
Notes®

Linked to the  
Dow Jones  
Industrial  
Average®, due  
December 23,  
2022

Structuring  
the Notes

The notes are our debt securities, the return on which is linked to the performance of the Index. As is the case for all of our debt securities, including our market-linked notes, the economic terms of the notes reflect our actual or perceived creditworthiness at the time of pricing. Because of the higher issuance, operational and ongoing management costs of market-linked notes as

compared to our conventional debt of the same maturity, as well as our liquidity needs and preferences, the assumed funding rate we use in pricing market-linked notes is generally lower than the interest rates implied by secondary market prices for our debt obligations and/or by other traded instruments referencing our debt obligations. This relatively lower assumed funding rate, which is reflected in the economic terms of the notes, along with other costs relating to selling, structuring, hedging and issuing the notes, resulted in the initial estimated value of the notes on the

pricing date being less than the public offering price. If the costs relating to selling, structuring, hedging and issuing the notes were lower, or if the funding rate we use to determine the economic terms of the notes were higher, the economic terms of the notes would be more favorable to you and the estimated value would be higher.

The Redemption Amount payable at maturity will be calculated based on the \$10 principal amount per unit and will depend on the performance of the Index. In order to meet these payment obligations, at the time we issue the notes, we expect to

enter into certain hedging arrangements (which may include call options, put options or other derivatives) with MLPF&S or one of its affiliates. The terms of these hedging arrangements are determined by seeking bids from market participants, which may include us, MLPF&S and one of our respective affiliates, and take into account a number of factors, including our creditworthiness, interest rate movements, the volatility of the Index, the tenor of the notes and the tenor of the hedging arrangements. The economic terms of the notes and their initial estimated value depend in part on the terms of these

hedging  
arrangements.

MLPF&S has advised us that the hedging arrangements will include a hedging related charge of approximately \$0.075 per unit, reflecting an estimated profit to be credited to MLPF&S from these transactions. Since hedging entails risk and may be influenced by unpredictable market forces, additional profits and losses from these hedging arrangements may be realized by us, MLPF&S or any other hedge providers. Any profit in connection with such hedging activity will be in addition to any other compensation that we, the agents, and our respective affiliates



receive for the sale of notes, which creates an additional incentive to sell the notes to you.

For further information, see Risk Factors General Risks Relating to LIRNs beginning on page PS-6 and Use of Proceeds and Hedging on page PS-16 of product supplement EQUITY INDICES LIRN-1.

Leveraged TS-13  
Index  
Return  
Notes®

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Leveraged  
Index Return  
Notes®

Linked to the  
Dow Jones  
Industrial  
Average®, due  
December 23,  
2022

United States  
Federal  
Income Tax  
Considerations

You should  
read carefully  
the discussion  
under United  
States Federal  
Tax  
Considerations  
in the  
accompanying  
product  
supplement  
and Selected  
Risk  
Considerations  
in this term  
sheet.

In the opinion  
of our  
counsel,  
Davis Polk &  
Wardwell  
LLP, which is  
based on  
current  
market  
conditions, a  
note should  
be treated as a  
prepaid

derivative contract that is an open transaction for U.S. federal income tax purposes. By purchasing a note, you agree (in the absence of an administrative determination or judicial ruling to the contrary) to this treatment. There is uncertainty regarding this treatment, and the Internal Revenue Service (the IRS ) or a court might not agree with it.

Assuming this treatment of the notes is respected and subject to the discussion in United States Federal Tax Considerations in the accompanying product supplement, the following U.S. federal income tax consequences should result under current law:

You should not recognize taxable income over the term of the notes prior to maturity, other than pursuant to a sale or exchange.

Upon a sale or exchange of a note (including retirement at maturity), you should recognize capital gain or loss equal to the difference between the amount realized and your tax basis in the note. Such gain or loss should be long-term capital gain or loss if you held the note for more than one year. Subject to the discussion below, if you are a non-U.S. holder (as defined in the accompanying

product supplement) of the notes, you generally should not be subject to U.S. federal withholding or income tax in respect of any amount paid to you with respect to the notes, provided that (i) income in respect of the notes is not effectively connected with your conduct of a trade or business in the United States, and (ii) you comply with the applicable certification requirements.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. The notice focuses in

particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors

should be subject to withholding tax; and whether these instruments are or should be subject to the

constructive ownership regime, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose a notional interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, including the character and timing of

income or loss and the degree, if any, to which income realized by non-U.S. persons should be subject to withholding tax, possibly with retroactive effect.

*Possible Withholding Under Section 871(m) of the Code.* Section 871(m) of the Code and Treasury regulations promulgated thereunder ( Section 871(m) ) generally impose a 30% withholding tax on dividend equivalents paid or deemed paid to non-U.S. holders with respect to certain financial instruments linked to U.S. equities ( U.S. underlying equities ) or indices that include U.S. underlying equities. Section 871(m)



generally applies to instruments that substantially replicate the economic performance of one or more U.S. underlying equities, as determined based on tests set forth in the applicable Treasury regulations (a specified equity-linked instrument or specified ELI ). However, the regulations exempt financial instruments issued in 2017 that do not have a delta of one. Based on the terms of the notes and representations provided by us, our counsel is of the opinion that the notes should not be treated as transactions that have a delta of one within the meaning of the regulations with respect

to any U.S. underlying equity and, therefore, should not be specified ELIs subject to withholding tax under Section 871(m).

A determination that the notes are not subject to Section 871(m) is not binding on the IRS, and the IRS may disagree with this treatment. Moreover, Section 871(m) is complex and its application may depend on your particular circumstances. For example, if you enter into other transactions relating to a U.S. underlying equity, you could be subject to withholding tax or income tax liability under Section 871(m) even if the notes are not specified

ELIs subject to Section 871(m) as a general matter. You should consult your tax adviser regarding the potential application of Section 871(m) to the notes.

In the event withholding applies, we will not be required to pay any additional amounts with respect to amounts withheld.

**You should read the section entitled United States Federal Tax Considerations in the accompanying product supplement. The preceding discussion, when read in combination with that section, constitutes the full opinion of Davis Polk & Wardwell LLP**

**regarding  
the material  
U.S. federal  
tax  
consequences  
of owning  
and  
disposing of  
the notes.**

**You should  
consult your  
tax adviser  
regarding all  
aspects of the  
U.S. federal  
income and  
estate tax  
consequences  
of an  
investment in  
the notes and  
any tax  
consequences  
arising under  
the laws of  
any state,  
local or  
non-U.S.  
taxing  
jurisdiction.**

Leveraged TS-14  
Index  
Return  
Notes®