Synacor, Inc.
Form 10-Q
August 15, 2016
Table of Contents

**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, 2016**

**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 001-33843**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware**<br>**(State or other jurisdiction**<br><br>**of incorporation)** | **16-1542712**<br>**(I.R.S. Employer**<br><br>**Identification No.)** |
| **40 La Riviere Drive, Suite 300**<br><br>**Buffalo, New York**<br>**(Address of principal executive offices)** | **14202**<br>**(Zip Code)** |

**Registrant s telephone number, including area code: (716) 853-1362**

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 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). Yes x No ¨

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

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

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

As of August 10, 2016, there were 30,291,012 shares of the registrant s common stock outstanding.

Table of Contents

## SYNACOR, INC. AND SUBSIDIARIES

## TABLE OF CONTENTS

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### SYNACOR, INC.

### CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED

### AS OF JUNE 30, 2016 AND DECEMBER 31, 2015

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

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 16,295 | $ 15,697 |
| Accounts receivable, net of allowance of $213 and $372, respectively | 19,052 | 24,341 |
| Prepaid expenses and other current assets | 5,188 | 3,290 |
| Total current assets | 40,535 | 43,328 |
| PROPERTY AND EQUIPMENT, net | 13,996 | 14,377 |
| GOODWILL | 15,949 | 15,187 |
| INTANGIBLE ASSETS, net | 15,881 | 14,798 |
| INVESTMENT | 1,000 | 1,000 |
| OTHER LONG-TERM ASSETS | 300 | 336 |
| Total assets | $ 87,661 | $ 89,026 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 10,704 | $ 9,004 |
| Accrued expenses and other current liabilities | 12,015 | 9,765 |
| Current portion of deferred revenue | 10,279 | 11,295 |
| Current portion of capital lease obligations | 1,472 | 1,574 |
| Total current liabilities | 34,470 | 31,638 |
| LONG-TERM PORTION OF CAPITAL LEASE OBLIGATIONS | 1,035 | 1,007 |
| LONG-TERM DEBT | 5,000 | 5,000 |
| DEFERRED REVENUE | 3,210 | 3,225 |
| OTHER LONG-TERM LIABILITIES | 500 | 2,052 |
| Total liabilities | 44,215 | 42,922 |
| COMMITMENTS AND CONTINGENCIES (Note 8) | | |

| | | |
|---|---|---|
| STOCKHOLDERS EQUITY: | | |
| Preferred stock par value $0.01 per share; authorized 10,000,000 shares; none issued | | |
| Common stock par value $0.01 per share; authorized 100,000,000 shares; 30,908,818 shares issued and 30,212,158 shares outstanding at June 30, 2016 and 30,636,327 shares issued and 29,983,279 shares outstanding at December 31, 2015 | 308 | 306 |
| Treasury stock at cost, 696,660 shares at June 30, 2016 and 653,048 shares at December 31, 2015 | (1,398) | (1,332) |
| Additional paid-in capital | 115,097 | 113,238 |
| Accumulated deficit | (70,432) | (66,110) |
| Accumulated other comprehensive (loss) income | (129) | 2 |
| Total stockholders equity | 43,446 | 46,104 |
| Total liabilities and stockholders equity | $ 87,661 | $ 89,026 |

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

1

Table of Contents

**SYNACOR, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

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

| | Three Months Ended June 30, 2016 | Three Months Ended June 30, 2015 | Six Months Ended June 30, 2016 | Six Months Ended June 30, 2015 |
|---|---|---|---|---|
| REVENUE | $ 30,476 | $ 24,716 | $ 60,736 | $ 51,446 |
| COSTS AND OPERATING EXPENSES: | | | | |
| Cost of revenue (exclusive of depreciation and amortization shown separately below) | 13,516 | 12,504 | 26,488 | 26,908 |
| Technology and development (exclusive of depreciation and amortization shown separately below) | 6,591 | 4,561 | 12,464 | 9,427 |
| Sales and marketing | 5,620 | 3,639 | 11,270 | 7,201 |
| General and administrative (exclusive of depreciation and amortization shown separately below) | 5,134 | 3,351 | 10,156 | 6,724 |
| Depreciation and amortization | 2,270 | 1,660 | 4,368 | 3,156 |
| Total costs and operating expenses | 33,131 | 25,715 | 64,746 | 53,416 |
| LOSS FROM OPERATIONS | (2,655) | (999) | (4,010) | (1,970) |
| OTHER INCOME, net | 242 | 17 | 244 | 1 |
| INTEREST EXPENSE | (84) | (59) | (152) | (109) |
| LOSS BEFORE INCOME TAXES AND EQUITY INTEREST | (2,497) | (1,041) | (3,918) | (2,078) |
| INCOME TAX PROVISION | 260 | 16 | 404 | 21 |
| LOSS IN EQUITY INTEREST | | (25) | | (57) |
| NET LOSS | $ (2,757) | $ (1,082) | $ (4,322) | $ (2,156) |
| NET LOSS PER SHARE: | | | | |
| Basic | $ (0.09) | $ (0.04) | $ (0.14) | $ (0.08) |
| Diluted | $ (0.09) | $ (0.04) | $ (0.14) | $ (0.08) |
| WEIGHTED AVERAGE SHARES USED TO COMPUTE NET LOSS PER SHARE: | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | 30,070,759 | 27,534,119 | 30,031,286 | 27,475,481 |
| Diluted | 30,070,759 | 27,534,119 | 30,031,286 | 27,475,481 |

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

Table of Contents

**SYNACOR, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS UNAUDITED**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

**(In thousands)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net loss | $ (2,757) | $ (1,082) | $ (4,322) | $ (2,156) |
| Other comprehensive income: | | | | |
| Changes in foreign currency translation adjustment | (187) | (3) | (131) | (6) |
| Comprehensive loss | $ (2,944) | $ (1,085) | $ (4,453) | $ (2,162) |

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

3

Table of Contents

**SYNACOR, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

**FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

**(In thousands)**

| | Six Months Ended June 30, 2016 | Six Months Ended June 30, 2015 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net loss | $ (4,322) | $ (2,156) |
| Adjustments to reconcile net loss to net cash provided by operating activities | | |
| Depreciation and amortization | 4,368 | 3,156 |
| Stock-based compensation expense | 1,424 | 1,541 |
| Loss in equity interest | | 57 |
| Changes in operating assets and liabilities, net of effect of acquisition: | | |
| Accounts receivable, net | 6,254 | 3,435 |
| Prepaid expenses and other assets | (1,866) | 381 |
| Accounts payable | 850 | (2,133) |
| Accrued expenses and other liabilities | (15) | (158) |
| Deferred revenue | (1,031) | 6 |
| Net cash provided by operating activities | 5,662 | 4,129 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Acquisition | (2,500) | |
| Purchases of property and equipment | (2,004) | (1,561) |
| Net cash used in investing activities | (4,504) | (1,561) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Repayments on capital lease obligations | (838) | (672) |
| Proceeds from exercise of common stock options | 336 | 70 |
| Treasury stock shares received to satisfy minimum tax withholdings | (66) | |
| Deferred acquisition payment | | (495) |
| Net cash used in financing activities | (568) | (1,097) |
| Effect of exchange rate changes on cash and cash equivalents | 8 | (8) |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS** | 598 | 1,463 |
| Cash and cash equivalents, beginning of period | 15,697 | 25,600 |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents, end of period | $ | 16,295 | $ | 27,063 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | | | |
| Cash paid for interest | $ | 132 | $ | 139 |
| Cash paid for income taxes | $ | | $ | 31 |
| SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS: | | | | |
| Liability for estimated additional acquisition consideration | $ | 567 | $ | |
| Property, equipment and service center contracts financed under capital lease obligations | $ | 673 | $ | 637 |
| Accrued property and equipment expenditures | $ | 39 | $ | 61 |
| Stock-based compensation capitalized to property and equipment | $ | 101 | $ | 89 |
| Treasury stock received to satisfy minimum withholding liabilities | $ | | $ | 123 |

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

Table of Contents

**SYNACOR, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED**

**AS OF JUNE 30, 2016 AND DECEMBER 31, 2015, AND**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015**

**1. The Company and Summary of Significant Accounting Principles**

Synacor, Inc., together with its consolidated subsidiaries (collectively, the Company or Synacor ), is the trusted technology development, multiplatform services and revenue partner for video, internet and communications providers, device manufacturers, and enterprises. Synacor delivers engaging, multiscreen experiences and advertising to their consumers that require scale, actionable data and sophisticated implementation.

**Basis of Presentation**

The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles ( U.S. GAAP ) and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company s management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company s financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period.

The accompanying condensed consolidated balance sheet as of December 31, 2015 was derived from the audited financial statements as of that date, but does not include all the information and footnotes required by U.S. GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2015.

**Accounting Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

**Concentrations of Risk**

As of June 30, 2016 and December 31, 2015, the Company had concentrations equal to or exceeding 10% of the Company s accounts receivable as follows:

| | Accounts Receivable | |
|---|---|---|
| | June 30, 2016 | December 31, 2015 |
| Google | 11% | 14% |

5

Table of Contents

For the three and six months ended June 30, 2016 and 2015, the Company had concentrations equal to or exceeding 10% of the Company s revenue as follows:

| | Revenue | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Google | 14% | 30% | 15% | 33% |

For the three and six months ended June 30, 2016 and 2015, the following customers received revenue-share payments equal to or exceeding 10% of the Company s cost of revenue. The costs represent revenue share paid to customers for their supply of Internet traffic on the Company s start experiences:

| | Cost of Revenue | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Customer A | 26% | 29% | 28% | 27% |
| Customer B | 14% | 10% | 12% | 10% |
| Customer C | Less than 10% | 11% | Less than 10% | 11% |

**Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standard Update ( ASU ) 2014-09 (ASU 2014-09) *Revenue from Contracts with Customers*. ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605) and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14 *Revenue from Contracts with Customers: Deferral of the Effective Date*, which deferred the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, with earlier application permitted as of annual reporting periods beginning after December 15, 2016. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, to clarify the implementation guidance on principal versus agent. In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing,* providing additional guidance relating to identifying performance obligations under ASU 2014-09 as well as licensing. The Company is currently assessing the financial impact of adopting these ASUs and the methods of adoption; however, given the scope of the new standard, the Company is currently unable to provide a reasonable estimate regarding the financial impact or which method of adoption will be elected. The Company is currently in the process of evaluating the impact of adoption of ASU 2014-09 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The objective of this update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods and is to be applied utilizing a modified retrospective approach. Early adoption is permitted. The Company is in the process of assessing the impact of the adoption of this ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The objective of this update is to simplify several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is in the process of assessing the impact of the adoption of this ASU on its consolidated financial statements.

Table of Contents

## 2. Acquisitions

*Technorati*

On February 19, 2016, the Company entered into an Asset Purchase Agreement to acquire substantially all of the assets of Technorati, Inc. ( Technorati ), an advertising technology company, for $3.0 million in cash (the Purchase Price ). The Company completed the acquisition on February 26, 2016 (the Closing ). The Company expects the acquisition of Technorati to drive additional advertising demand, to accelerate its content and advertising syndication strategy by giving the Company access to over 1,000 new publishers, and to add new tools for publishers to its existing platform. The Company expects to realize synergies and economies of scale by combining Technorati s publisher network, proprietary SmartWrapper solution and other advertising technology with its existing network of Managed Portals and Advertising solutions.

The assets acquired include Technorati s intellectual property and advertising technology platforms, customer and publisher relationships, accounts receivable and equipment. The Company also assumed certain obligations of Technorati, including post-Closing obligations under contracts assigned to the Company and the payment of outstanding liabilities to its publishers. Ten of Technorati s employees commenced employment with Synacor.

The Company paid $2.5 million of the Purchase Price at the Closing, withheld $0.5 million of the purchase price to secure Technorati s indemnification obligations under the Asset Purchase Agreement, and owes Technorati approximately $0.1 million in post-closing working capital adjustments. Pursuant to the terms of the Asset Purchase Agreement, Technorati shall indemnify the Company for breaches of its representations and warranties, breaches of covenants and certain other matters. The representations and warranties set forth in the Asset Purchase Agreement generally survive for 12 months following the Closing, with longer survival periods for certain fundamental representations and warranties.

**Consideration and Allocation of Purchase Price**

The transaction was accounted for as a purchase in accordance with FASB Accounting Standards Codification ( ASC ) Topic 805, *Business Combinations*. Under this guidance, the fair value of the consideration was determined and the assets acquired and liabilities assumed have been recorded at their estimated fair values as of the date of acquisition. The excess of the consideration over the estimated fair values has been recorded as goodwill.

The estimated transaction consideration, as well as the preliminary allocation of the purchase price to the assets acquired and liabilities assumed as of the date of the acquisition are presented in the table below. Management is responsible for determining, as of the Closing, the fair value of tangible and identifiable intangible assets acquired and liabilities assumed, and the estimated useful lives for any depreciable and amortizable assets. Management considered a number of factors, including reference to a valuation analysis performed solely for the purpose of this allocation in accordance with ASC Topic 805. The Company s estimates are based on assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. This analysis required the use of management s assumptions, which would not reflect unanticipated events and circumstances that may occur.

Consideration (in thousands):

| | |
|---|---|
| Cash consideration | $ 2,500 |
| Fair value of indemnification holdback | 500 |
| Fair value of post-closing working capital adjustment | 67 |

| | |
|---|---|
| Total consideration | $ 3,067 |

Table of Contents

Purchase price allocation (in thousands):

| | |
|---|---|
| Assets acquired: | |
| Accounts receivable | $ 965 |
| Property and equipment | 96 |
| Customer and publisher relationships | 1,380 |
| Technology | 730 |
| Goodwill | 751 |
| Total assets acquired | 3,922 |
| Liabilities assumed: | |
| Accounts payable and accrued expenses | 855 |
| Net assets acquired | $ 3,067 |

While the Company has used its best estimates and assumptions to value the assets acquired and liabilities assumed, the purchase price allocation is preliminary and could change during the measurement period, not to exceed one year, if new information is obtained about the facts and circumstances that existed as of the Closing, that if known would have resulted in the recognition of additional assets or liabilities or resulted in changes in the recorded values of assets and liabilities. It is expected that acquired goodwill will be deductible for United States tax purposes. We will amortize technology and customer and publisher relationships over estimated useful lives of five years.

Acquisition costs of $0.1 million were incurred during the first quarter of 2016 and charged to general and administrative expense.

***Zimbra***

As more fully discussed in our Annual Report on Form 10-K for the year ended December 31, 2015, on August 18, 2015 the Company and Sync Holdings, LLC, its wholly-owned subsidiary, entered into an Asset Purchase Agreement (the Asset Purchase Agreement ) with Zimbra, Inc. (now known as TZ Holdings) to acquire certain assets related to TZ Holdings email/collaboration products and services business, including certain of its wholly-owned foreign subsidiaries. The business acquired by the Company pursuant to the Asset Purchase Agreement is referred to herein as Zimbra. Zimbra includes software for email/collaboration, calendaring, file sharing, activity streams and social networks, among other things. The Zimbra software is used globally by service providers, governments and companies. The Company completed the acquisition (the Acquisition ) on September 14, 2015 (the Closing ).

**Pro Forma Results**

The following unaudited pro forma information presents the combined results of the Company s operations as if the Acquisition had been completed on January 1, 2014, the beginning of the comparable prior reporting periods. The unaudited pro forma results include adjustments to reflect: (i) the carve-out of revenue and expenses relating to the portion of the Zimbra business not acquired; (ii) the elimination of depreciation and amortization from Zimbra s historical financial statements and the inclusion of depreciation and amortization based on the fair values of acquired property, plant and equipment and intangible assets; (iii) the fair value of deferred revenue liabilities assumed; (iv) recognition of the post-acquisition share-based compensation expense related to stock options that were granted to Zimbra employees who accepted employment with Synacor; (v) the elimination of intercompany revenue and expenses between Zimbra and Synacor; and (iv) the elimination of acquisition-related expenses.

The unaudited pro forma results do not reflect any cost saving synergies from operating efficiencies or the effect of the incremental costs incurred in integrating the two companies. Accordingly, these unaudited pro forma results are presented for informational purpose only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisition had occurred at the beginning of the periods presented, nor are they indicative of future results of operations.

Table of Contents

Set forth below is the unaudited pro forma consolidated results of operations of the Company and Zimbra as if the Acquisition occurred as of January 1, 2014 (in thousands, except per share amounts):

| | Three months ended June 30, 2015 | Six months ended June 30, 2015 |
|---|---|---|
| Revenue | $ 31,042 | $ 64,413 |
| Operating loss | $ (1,636) | (3,313) |
| Net loss | $ (2,093) | $ (4,246) |
| Net loss per share (basic and diluted): | $ (0.07) | $ (0.14) |

**3. Fair Value Measurements**

In August 2015, the Company and Zimbra, Inc. (now known as TZ Holdings ) entered into an agreement under which the Company acquired certain assets relating to TZ Holdings email/collaboration products and services business, including certain of its foreign subsidiaries, for cash consideration of $17.3 million, 2.4 million shares of common stock and warrants to purchase 480,000 shares of common stock (collectively valued at $3.2 million). The Company also held back an additional 600,000 shares of common stock and warrants to purchase an additional 120,000 shares of common stock (collectively valued at $0.8 million) to secure TZ Holdings indemnification claims including pending claims.

Additionally, TZ Holdings is eligible to receive cash consideration of up to $2.0 million (the Earn-Out Consideration ) upon the satisfaction of certain business performance milestones following the closing of the transaction, subject to and contingent upon any reduction to satisfy indemnification claims including pending claims. Should the business performance milestones be met, the payments under this arrangement will be partially due in the fourth quarter of 2016 and partially in the second quarter of 2017. The fair value of the Earn-Out Consideration was determined to be $1.6 million, and the liability for Earn-Out Consideration is included in accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheet as of June 30, 2016.

The provisions of ASC Topic 820, *Fair Value Measurements and Disclosures*, establish a framework for measuring the fair value in accordance with U.S. GAAP and establish a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value as follows:

*Level 1* Level 1 inputs are defined as observable inputs such as quoted prices in active markets.

*Level 2* Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

*Level 3* Level 3 inputs are unobservable inputs that reflect the Company s determination of assumptions that market participants would use in pricing the asset or liability. These inputs are developed based on the best information available, including the Company s own data.

Table of Contents

The Company classifies the Earn-Out Consideration within Level 3 because it is valued using unobservable inputs. There was no change to the Company s estimate of the fair value of the Earn-Out Consideration during the three and six months ended June 30, 2016.

## 4. Goodwill and Other Intangible Assets

The change in goodwill is as follows for the six months ended June 30, 2016 (in thousands):

| | Six Months Ended June 30, 2016 | |
|---|---|---|
| Balance beginning of period | $ | 15,187 |
| Acquisition of Technorati | | 751 |
| Effect of foreign currency translation | | 11 |
| Balance end of period | $ | 15,949 |

Intangible assets, net consisted of the following (in thousands):

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Customer and publisher relationships | $ 14,780 | $ 13,400 |
| Technology | 2,330 | 1,600 |
| Trademark | 300 | 300 |
| | 17,410 | 15,300 |
| Less accumulated amortization | (1,529) | (502) |
| Intangible assets, net | $ 15,881 | $ 14,798 |

Amortization of intangible assets for the three months ended June 30, 2016 and 2015 was $0.6 million and zero, respectively. Amortization of intangible assets for the six months ended June 30, 2016 and 2015 was $1.0 million and zero, respectively.

## 5. Property and Equipment Net

Property and equipment, net consisted of the following (in thousands):

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Computer equipment (1) | $ 22,999 | $ 23,324 |

| | | |
|---|---|---|
| Computer software | 16,304 | 12,748 |
| Furniture and fixtures | 1,959 | 1,945 |
| Leasehold improvements | 1,549 | 1,532 |
| Work in process (primarily software development costs) | 522 | 2,065 |
| Other | 205 | 252 |
| | 43,538 | 41,866 |
| Less accumulated depreciation (2) | (29,542) | (27,489) |
| Property and equipment, net | $ 13,996 | $ 14,377 |

Table of Contents

Depreciation expense for the three months ended June 30 of both 2016 and 2015 was $1.7 million. Depreciation expense for the six months ended June 30, 2016 and 2015 was $3.3 million and $3.2 million, respectively.

Notes:

(1) Includes equipment and software held under capital leases of $4.9 million and $4.1 million as of June 30, 2016 and December 31, 2015, respectively.
(2) Includes $2.6 million and $1.8 million of accumulated depreciation of equipment under capital leases as of June 30, 2016 and December 31, 2015, respectively.

**6. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consisted of the following (in thousands):

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Accrued compensation | $ 4,991 | $ 6,112 |
| Accrued content fees | 2,354 | 1,964 |
| Contingent consideration | 1,600 | |
| Accrued business acquisition consideration | 567 | |
| Other | 2,503 | 1,689 |
| Total | $ 12,015 | $ 9,765 |

**7. Information About Segment and Geographic Areas**

Operating segments are components of the Company in which separate financial information is available that is evaluated regularly by the Company s chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. Profitability measures by service line are not prepared or used. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following tables set forth revenue and long-lived tangible assets by geographic area (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Revenue: | | | | |

| | | | | |
|---|---|---|---|---|
| United States | $ 26,149 | $ 24,537 | $ 52,619 | $ 51,067 |
| International | 4,327 | 179 | 8,117 | 379 |
| Total revenue | $ 30,476 | $ 24,716 | $ 60,736 | $ 51,446 |

Table of Contents

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Long-lived tangible assets: | | |
| United States | $ 12,999 | $ 12,909 |
| Canada | 688 | 726 |
| Other international | 309 | 742 |
| Total long-lived tangible assets | $ 13,996 | $ 14,377 |

## 8. Commitments and Contingencies

**Contract Commitments** The Company is obligated to make payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of June 30, 2016 are summarized as follows (in thousands):

| | |
|---|---|
| Year ending December 31, | |
| 2016 (remaining six months) | $ 2,100 |
| 2017 | 2,080 |
| 2018 | 720 |
| Total | $ 4,900 |

**Contingent Consideration**

In connection with the Company s acquisition of certain email/collaboration assets from TZ Holdings in September 2015 (see Note 3), the Company is obligated to pay contingent cash consideration totaling up to $2.0 million upon the satisfaction of certain business performance milestones following the closing of the transaction, subject to and contingent upon any reduction to satisfy indemnification claims including pending claims. This liability is valued at $1.6 million, and at June 30, 2016 is included in accrued expenses and other current liabilities. Additionally, the Company also held back an additional 600,000 shares of common stock and warrants to purchase an additional 120,000 shares of common stock (collectively valued at $0.8 million) to secure TZ Holdings indemnification claims including pending claims.

In connection with the Company s acquisition of the Technorati assets (see Note 2), the Company withheld $0.5 million of the purchase price to secure Technorati s indemnification obligations under the Asset Purchase Agreement, with payment under this arrangement due in the first quarter of 2017. Additionally, the Company owes approximately $0.1 million in post-closing working capital adjustments. This amount is included in accrued expenses and other current liabilities at June 30, 2016.

**Litigation**

From time to time, the Company is a party to legal actions. In the opinion of management, the outcome of these matters is not expected to have a material impact on the consolidated financial statements of the Company.

**9. Stock-based Compensation**

The Company has stock-based employee compensation plans for which compensation cost is recognized in its financial statements. The cost is measured at the grant date, based on the fair value of the award, determined using the Black-Scholes option pricing model, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity award).

12

Table of Contents

No income tax deduction is allowed for incentive stock options ( ISOs ). Accordingly, no deferred income tax asset is recorded for the potential tax deduction related to these options. Expense related to stock option grants of non-qualified stock options ( NSOs ) results in a temporary difference, which gives rise to a deferred tax asset. No such asset is recognized in the accompanying balance sheets as the Company has fully reserved its net deferred tax assets due to the uncertainty of future realization of those assets.

Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Technology and development | $ 202 | $ 253 | $ 443 | $ 470 |
| Sales and marketing | 208 | 244 | 431 | 485 |
| General and administrative | 277 | 303 | 550 | 586 |
| Total stock-based compensation expense | $ 687 | $ 800 | $ 1,424 | $ 1,541 |

Stock Option Activity A summary of the stock option activity for the six months ended June 30, 2016 is presented below:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at January 1, 2016 | 8,695,918 | $ 2.57 | | |
| Granted | 1,135,000 | $ 1.94 | | |
| Exercised | (157,612) | $ 2.21 | | |
| Forfeited or expired | (217,039) | $ 2.01 | | |
| Outstanding at June 30, 2016 | 9,456,267 | $ 2.51 | 7.33 | $ 7,715 |
| Vested and expected to vest at June 30, 2016 | 8,998,282 | $ 2.54 | 7.06 | $ 7,216 |
| Vested and exercisable at June 30, 2016 | 4,693,872 | $ 3.00 | 5.48 | $ 2,662 |

Aggregate intrinsic value represents the difference between the Company s closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company s closing stock price as reported on the NASDAQ Global Market as of June 30, 2016 was $3.08 per share. The total intrinsic value of options exercised for the six months ended June 30, 2016 was $0.1 million. The weighted average fair value of options issued during the six months ended June 30, 2016 amounted to $0.90 per option share.

As of June 30, 2016, the unrecognized compensation cost related to non-vested options granted, for which vesting is probable, and adjusted for estimated forfeitures, was approximately $4.8 million. This cost is expected to be recognized over a weighted-average period of 2.6 years. The total fair value of shares vested was $1.1 million for the six months ended June 30, 2016.

Table of Contents

In addition, the Company may, from time to time, grant Restricted Stock Units ( RSUs ) to its employees. A summary of RSU activity for the six months ended June 30, 2016 is presented below:

| | Number of Shares | Weighted Average Fair Value |
|---|---|---|
| Unvested - January 1, 2016 | 437,595 | $ 2.31 |
| Shares granted | 123,000 | $ 3.64 |
| Shares vested | (109,031) | $ 2.40 |
| Forfeited or expired | (15,712) | $ 2.62 |
| Unvested - June 30, 2016 | 435,852 | $ 2.65 |
| Expected to vest - June 30, 2016 | 402,732 | $ 2.65 |

**10. Net Income (Loss) Per Common Share Data**

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company s potential common shares consist of the incremental common shares issuable upon the exercise of stock options, and to a lesser extent, shares issuable upon the release of RSUs. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

Stock options, warrants and RSUs are not included in the calculation of diluted net loss per share for the three and six months ended June 30, 2016 and 2015 because the Company had a net loss for those periods. The inclusion of these equity awards would have had an antidilutive effect on the calculation of diluted loss per share. As such, the Company s calculations of basic and diluted net loss per share are identical.

The following equivalent shares were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Anti-dilutive equity awards: | | | | |
| Stock options and Restricted Stock Units | 9,892,119 | 8,278,318 | 9,892,119 | 8,278,318 |
| Warrants | 480,000 | | 480,000 | |

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

*This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and* *future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as may, expect, believe, anticipate, intend, could, estimate, or continue, and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations. Factors that could cause or contribute to such*

Table of Contents

*differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included elsewhere in this Form 10-Q and in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management s discussion and analysis of financial condition and results of operations appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.*

**Our Business**

We enable our customers to better engage with their consumers. Our customers include video, internet and communications providers, device manufacturers and enterprises. We are their trusted technology development, multiplatform services and revenue partner.

We enable our customers to provide their consumers engaging, multiscreen experiences with products that require scale, actionable data and sophisticated implementation. Through our Managed Portals and Advertising solutions, we enable our customers to earn incremental revenue by monetizing media among their consumers. At the same time, because consumers have high expectations for their online experience as a result of advances in video, mobile and social, we provide, through our Recurring and Fee-Based Revenue solutions, a suite of products and services that helps our customers successfully meet those high expectations by enabling them to deliver to their consumers access to the same digital content across all devices, including PCs, tablets, smartphones and connected TVs.

**Overview**

We generate search and digital advertising revenue from consumer traffic on our Managed Portals and Advertising solutions, which we collect from our search partner, Google Inc., or Google, our advertising network providers and directly from advertisers. We typically share a portion of this Managed Portals and Advertising revenue with our customers. Growth in our business is dependent on expansion of relationships with our existing customers and new customers adopting our Managed Portals and Advertising solutions and increased engagement by their consumers with these solutions.

We also generate revenue from our Recurring and Fee-Based Revenue solutions for the use of our technology, email and messaging, premium services and paid content. We generate this revenue in the form of licensing fees, including perpetual licenses, subscription licenses, maintenance and support fees, and professional services. As we expand our Cloud ID, syndicated content, Email/Collaboration and other premium services offerings, we expect to generate increased Recurring and Fee-Based revenue from our customers.

During the three and six months ended June 30, 2016, Managed Portals and Advertising revenue was $17.5 million and $34.8 million, a decrease of 8% and 12% as compared to $19.0 million and $39.6 million for the three and six months ended June 30, 2015.

Digital advertising revenue increased by $1.7 million and $2.8 million during the three and six months ended June 30, 2016, respectively, as compared to the same periods in 2015, as a result of an increase in video advertising and higher contractual rates for advertising, as well as the additional revenue resulting from our February 2016 acquisition of certain assets of Technorati, Inc., or Technorati, an advertising technology company. Combining Technorati s publisher network and proprietary advertising technologies with our existing network of Managed Portals and Advertising solutions creates a large-scale media solutions platform that enables our customers to increase engagement with their consumers and further monetize that engagement. This acquisition is driving additional advertising demand, accelerating our content and advertising syndication strategy by giving us access to over 1,000 new publishers; additionally, the acquisition has enabled us to add new tools for publishers to our platform.

We anticipate video advertising may become an increasing percentage of our advertising revenue which may also serve to increase our advertising revenue per thousand impressions (referred to as cost per mille or CPMs). We also anticipate that the signing of new customers and launching new mobile app products may help add new Managed Portals and Advertising revenue in future years.

Search revenue decreased by $3.2 million, or 43%, for the three months ended June 30, 2016 compared to the same period in 2015, and decreased by $7.6 million, or 45% for the six months ended June 30, 2016 as compared to the same six months in 2015. We believe the decrease was due to continued migration of search activity from personal computers to other devices, such as tablets and smartphones, generally across the consumer base, and the residual effect of the placement of our Managed Portals and Advertising solutions on the second tab of the default Windows 8 internet browser by our consumer electronics customers.

Table of Contents