

Shutterstock, Inc.
Form 10-Q
April 25, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

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: 001-35669

SHUTTERSTOCK, INC.

(Exact name of registrant as specified in its charter)

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

Shutterstock, Inc.
350 Fifth Avenue, 21st Floor
New York, NY 10118
(Address of principal executive offices, including zip code)
(646) 710-3417
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 Exchange Act.

Large accelerated filer Accelerated filer

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

Smaller reporting company

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Emerging growth company

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.

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

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

Class	Outstanding at April 19, 2019
Common Stock, \$0.01 par value per share	35,215,629

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, particularly in the discussion under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Examples of forward-looking statements include, but are not limited to, statements regarding future business, future results of operations or financial condition, new or planned features, products or services, or management strategies. You can identify these forward-looking statements by words such as “may,” “will,” “would,” “should,” “could,” “expect,” “anticipate,” “believe,” “estimate,” “intend,” “plan” and other similar expressions. However, not all forward-looking statements contain these words. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those discussed under the caption “Risk Factors” in our most recently filed Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission, or the SEC, on February 26, 2019, and in our consolidated financial statements, related notes, and the other information appearing elsewhere in such report, this report on Form 10-Q and our other filings with the SEC. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. We do not intend, and, except as required by law, we undertake no obligation, to update any of our forward-looking statements after the date of this report to reflect actual results or future events or circumstances. Unless the context otherwise indicates, references in this Quarterly Report on Form 10-Q to the terms “Shutterstock,” “the Company,” “we,” “our” and “us” refer to Shutterstock, Inc. and its subsidiaries. “Shutterstock,” “Offset,” “Bigstock,” “ReFeatures,” “PremiumBeat” and “Shutterstock Editor” and their logos are registered trademarks and are the property of Shutterstock, Inc. or one of our subsidiaries. All other trademarks, service marks and trade names appearing in this Quarterly Report on Form 10-Q are the property of their respective owners.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Shutterstock, Inc.

Consolidated Balance Sheets

(In thousands, except par value amount)

(unaudited)

	March 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$240,141	\$ 230,852
Accounts receivable, net	45,449	41,028
Prepaid expenses and other current assets	35,378	34,841
Total current assets	320,968	306,721
Property and equipment, net	72,553	76,188
Right-of-use assets	46,313	—
Intangible assets, net	29,048	29,540
Goodwill	88,889	88,576
Deferred tax assets, net	11,636	12,375
Other assets	18,090	18,088
Total assets	\$587,497	\$ 531,488
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$4,941	\$ 7,212
Accrued expenses	53,887	51,385
Contributor royalties payable	25,156	22,971
Deferred revenue	137,368	139,604
Other current liabilities	10,858	2,131
Total current liabilities	232,210	223,303
Deferred tax liability, net	—	77
Lease liabilities	48,591	—
Other non-current liabilities	11,712	21,441
Total liabilities	292,513	244,821
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Common stock, \$0.01 par value; 200,000 shares authorized; 37,759 and 37,618 shares issued and 35,201 and 35,060 shares outstanding as of March 31, 2019 and December 31, 2018, respectively	378	376
Treasury stock, at cost; 2,558 shares as of March 31, 2019 and December 31, 2018	(100,027)	(100,027)
Additional paid-in capital	292,458	291,710
Accumulated comprehensive loss	(6,426)	(6,471)
Retained earnings	108,601	101,079
Total stockholders' equity	294,984	286,667
Total liabilities and stockholders' equity	\$587,497	\$ 531,488
See Notes to Unaudited Consolidated Financial Statements.		

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Shutterstock, Inc.

Consolidated Statements of Operations

(In thousands, except for per share data)

(unaudited)

	Three Months Ended March 31,	
	2019	2018
Revenue	\$ 163,332	\$ 153,019
Operating expenses:		
Cost of revenue	69,218	64,490
Sales and marketing	44,446	40,368
Product development	14,986	16,448
General and administrative	26,583	27,224
Total operating expenses	155,233	148,530
Income from operations	8,099	4,489
Gain on Sale of Webdam	—	38,613
Other income, net	896	802
Income before taxes	8,995	43,904
Provision for income taxes	1,473	11,323
Net income	\$ 7,522	\$ 32,581
Earnings per share:		
Basic	\$ 0.21	\$ 0.94
Diluted	\$ 0.21	\$ 0.92
Weighted average shares outstanding:		
Basic	35,114	34,784
Diluted	35,491	35,318

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.
Consolidated Statements of Comprehensive Income
(In thousands)
(unaudited)

	Three Months Ended March 31,	
	2019	2018
Net income	\$7,522	\$32,581
Foreign currency translation gain	45	1,075
Other comprehensive income	45	1,075
Comprehensive income	\$7,567	\$33,656

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.
 Consolidated Statements of Stockholders' Equity
 (In thousands)
 (unaudited)

	Common Stock		Treasury Stock		Additional	Accumulated	Retained	
	Shares	Amount	Shares	Amount	Paid-in	Other	Earnings	Total
					Capital	Comprehensiv Loss		
Balance at December 31, 2018	37,618	\$ 376	2,558	\$(100,027)	\$291,710	\$ (6,471)	\$ 101,079	\$286,667
Equity-based compensation	—	—	—	—	4,624	—	—	4,624
Issuance of common stock in connection with employee stock option exercises and RSU vesting	229	3	—	—	214	—	—	217
Common shares withheld for settlement of taxes in connection with equity-based compensation	(88)	(1)	—	—	(4,090)	—	—	(4,091)
Other comprehensive loss	—	—	—	—	—	45	—	45
Net income	—	—	—	—	—	—	7,522	7,522
Balance at March 31, 2019	37,759	\$ 378	2,558	\$(100,027)	\$292,458	\$ (6,426)	\$ 108,601	\$294,984
	Common Stock		Treasury Stock		Additional	Accumulated	Retained	
	Shares	Amount	Shares	Amount	Paid-in	Other	Earnings	Total
					Capital	Comprehensiv Loss		
Balance at December 31, 2017	37,270	\$ 373	2,558	\$(100,027)	\$272,657	\$ (3,557)	\$ 145,139	\$314,585
Cumulative Effect of Accounting Change (See Note 1)	—	—	—	—	—	—	6,178	6,178
Balance at January 1, 2018	37,270	\$ 373	2,558	\$(100,027)	\$272,657	\$ (3,557)	\$ 151,317	\$320,763
Equity-based compensation	—	—	—	—	5,606	—	—	5,606
Issuance of common stock in connection with employee stock option exercises and RSU vesting	252	3	—	—	1,176	—	—	1,179
Common shares withheld for settlement of taxes in connection with equity-based compensation	(83)	(1)	—	—	(4,039)	—	—	(4,040)
Other comprehensive loss	—	—	—	—	—	1,075	—	1,075
Net income	—	—	—	—	—	—	32,581	32,581
Balance at March 31, 2018	37,439	\$ 375	2,558	\$(100,027)	\$275,400	\$ (2,482)	\$ 183,898	\$357,164

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Three Months Ended March 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$7,522	\$32,581
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,916	10,943
Deferred taxes	699	(1,644)
Non-cash equity-based compensation	4,624	5,606
Gain on Sale of Webdam	—	(38,613)
Bad debt expense	(632)	238
Changes in operating assets and liabilities:		
Accounts receivable	(3,812)	561
Prepaid expenses and other current and non-current assets	(2,782)	(7,688)
Accounts payable and other current and non-current liabilities	1,994	15,247
Contributor royalties payable	2,138	3,027
Deferred revenue	(1,958)	836
Net cash provided by operating activities	\$19,709	\$21,094
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(7,253)	(14,975)
Acquisition of businesses, net of cash acquired	—	(845)
Proceeds from Sale of Webdam, net	2,500	42,338
Other investments / advances	—	(15,000)
Acquisition of digital content	(545)	(635)
Security deposit release	—	34
Net cash used in investing activities	\$(5,298)	\$10,917
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	214	1,185
Cash paid related to settlement of employee taxes related to RSU vesting	(4,090)	(4,033)
Net cash used in financing activities	\$(3,876)	\$(2,848)
Effect of foreign exchange rate changes on cash	(1,246)	2,291
Net increase in cash, cash equivalents and restricted cash	9,289	31,454
Cash, cash equivalents and restricted cash, beginning of period	233,465	256,041
Cash, cash equivalents and restricted cash, end of period	\$242,754	\$287,495
Supplemental Disclosure of Cash Information:		
Cash paid / (received) for income taxes	\$305	\$(1,835)
See Notes to Unaudited Consolidated Financial Statements.		

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Shutterstock, Inc.

Notes to Consolidated Financial Statements

(unaudited)

(1) Summary of Operations and Significant Accounting Policies

Summary of Operations

Shutterstock, Inc., together with its subsidiaries (collectively, the “Company” or “Shutterstock”), is a global technology company offering a creative platform, which provides high-quality digital content, tools and services to creative professionals. The digital content licensed by the Company’s customers includes: (a) imagery, consisting of licensed photographs, vectors, illustrations and video clips, which is used in visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content; and (b) music, consisting of high-quality music tracks and sound effects, which is often used to complement digital imagery. The Company licenses content to its customers. Contributors upload their content to the Company’s web properties in exchange for royalty payments based on customer download activity. The Company also offered digital asset management services through its cloud-based digital asset management platform (“Webdam”). As discussed in Note 3, on February 26, 2018, the Company completed a sale transaction, pursuant to which the buyer in the transaction acquired certain assets and assumed certain contracts and liabilities which constituted the Company’s digital asset management business (the “Sale of Webdam”).

Basis of Presentation

The unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all information and footnotes required by GAAP for complete financial statements. The interim Consolidated Balance Sheet as of March 31, 2019, Consolidated Statements of Operations, Comprehensive Income, Stockholders’ Equity and Cash Flows for the three months ended March 31, 2019 and 2018, are unaudited. The Consolidated Balance Sheet as of December 31, 2018, included herein, was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP. These unaudited interim financial statements have been prepared on a basis consistent with the Company’s annual financial statements and, in the opinion of management, reflect all adjustments, which include all normal recurring adjustments necessary to state fairly the Company’s financial position as of March 31, 2019, its consolidated results of operations and comprehensive income for the three months ended March 31, 2019 and 2018, and its cash flows for the three months ended March 31, 2019 and 2018. The financial data and the other financial information disclosed in the notes to the financial statements related to these periods are also unaudited. The results of operations for the three months ended March 31, 2019 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2019 or for any other future annual or interim period.

These financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2018 included in the Company’s Annual Report on Form 10-K, which was filed with the SEC on February 26, 2019. The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Certain immaterial changes in presentation have been made to conform the prior period presentation to current period reporting.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Such estimates include, but are not limited to, the determination of the allowance for doubtful

accounts, the volume of expected unused licenses for our subscription-based products, the assessment of recoverability of property and equipment, the fair value of acquired goodwill and intangible assets, the grant-date fair value of non-cash equity-based compensation, the assessment of recoverability of deferred tax assets, the measurement of income tax and contingent non-income tax liabilities and the determination of the incremental borrowing rate to calculate the lease liability.

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Shutterstock, Inc.

Notes to Consolidated Financial Statements

(unaudited)

Cash, Cash Equivalents and Restricted Cash

The following represents the Company's cash, cash equivalents and restricted cash as of March 31, 2019 and December 31, 2018 (in thousands):

	As of March 31, 2019	As of December 31, 2018
Cash and cash equivalents	\$ 240,141	\$ 230,852
Restricted cash	2,613	2,613
Total cash, cash equivalents and restricted cash	\$ 242,754	\$ 233,465

The Company's cash and cash equivalents consist primarily of (i) cash on hand and bank deposits and (ii) money market accounts. These assets are stated at cost, which approximates fair value.

The Company's restricted cash relates to security deposits related to the lease for its headquarters in New York City, which expires in 2029. The carrying value of restricted cash approximates fair value. Restricted cash is included as a component of other assets on the Consolidated Balance Sheets.

Allowance for Doubtful Accounts

The Company's accounts receivable consists of customer obligations due under normal trade terms, carried at their face value less an allowance for doubtful accounts, if required. The Company determines its allowance for doubtful accounts based on an evaluation of the aging of its accounts receivable and on a customer-by-customer basis where appropriate. The Company's reserve analysis contemplates the Company's historical loss rate on receivables, specific customer situations and the economic environments in which the Company operates. During the three months ended March 31, 2019, the Company reduced its allowance for doubtful accounts which included a \$0.6 million benefit recorded to bad debt expense and \$0.1 million related to write-offs and other adjustments. As of March 31, 2019 and December 31, 2018, the Company's allowance for doubtful accounts was approximately \$4.0 million and \$4.7 million, respectively, which was included as a reduction of accounts receivable.

Chargeback and Sales Refund Allowance

The majority of the Company's customers purchase products by making an electronic payment with a credit card at the time of a transaction. The Company establishes a chargeback allowance and sales refund reserve allowance based on factors surrounding historical credit card chargeback trends, historical sales refund trends and other information. As of March 31, 2019 and December 31, 2018, the Company's combined allowance for chargebacks and sales refunds was \$0.3 million and \$0.3 million, respectively, which was included in other liabilities.

Revenue Recognition

The majority of the Company's revenue is earned from the license of digital content. Digital content licenses are generally purchased on a monthly or annual subscription basis, whereby a customer pays for a predetermined quantity of content that may be downloaded over a specific period of time, or, on a transactional basis, whereby a customer pays for individual content licenses at the time of download. Prior to the Sale of Webdam, the Company also earned revenue from licensing hosted software services through Webdam's cloud-based tools for businesses, which were purchased as part of a subscription.

The Company recognizes revenue upon the satisfaction of performance obligations, which occurs when (i) digital content is downloaded by a customer or (ii) hosted software services are provisioned and available to a customer. For digital content licenses, the Company recognizes revenue on both its subscription-based and transaction-based sales when content is downloaded, at which time the license is provided. In addition, management estimates expected unused licenses for subscription-based products and recognizes the revenue associated with the unused licenses throughout the subscription period. The estimate of unused licenses is based on historical download activity and future

changes in the estimate could impact the timing of revenue recognition of the Company's subscription products. Revenue associated with hosted software services is recognized ratably over the term of the license. The Company expenses contract acquisition costs as incurred, to the extent that the amortization period would otherwise be one year or less.

Collectability is reasonably assured at the time the electronic order or contract is entered. The majority of the Company's customers purchase products by making electronic payments at the time of the transaction with a credit card. The Company establishes an allowance for credit card chargebacks and a sales refund reserve based on factors surrounding historical chargeback and sales refund trends and other information. Customer payments received in advance of revenue recognition are contract liabilities and are recorded as deferred revenue. Customers that do not pay in advance are invoiced and are required to

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Shutterstock, Inc.

Notes to Consolidated Financial Statements

(unaudited)

make payments under standard credit terms. Collectability for customers who pay on credit terms allowing for payment beyond the date at which service commences, is based on a credit evaluation for certain new customers and transaction history with existing customers.

The Company recognizes revenue gross of contributor royalties because the Company is the principal in the transaction as it is the party responsible for the performance obligation and it controls the product or service before transferring it to the customer. The Company also licenses content to customers through third-party resellers.

Third-party resellers sell the Company's products directly to customers as the principal in those transactions.

Accordingly, the Company recognizes revenue net of costs paid to resellers.

The Company adopted Financial Accounting Standards Board ("FASB") Accounting Standard Update ("ASU") 2014-09, as amended ("ASU 2014-09"), on January 1, 2018 using the modified retrospective approach, and prior period amounts were not restated. The effect of adoption of this new guidance on the Consolidated Balance Sheet as of January 1, 2018 was to reduce (i) prepaid expenses and other current assets by \$3.7 million and (ii) deferred revenues by \$9.9 million, with an offsetting \$6.2 million increase in 2018 opening retained earnings.

Leasing

The Company records rent expense on a straight-line basis over the term of the related lease. Prior to the adoption of FASB ASU 2016-02, Leases (Topic 842), as amended ("ASC 842"), the difference between the rent expense recognized and the actual payments made in accordance with the operating lease agreement was recognized as a deferred rent liability on the Company's balance sheet. As of December 31, 2018, the Company had deferred rent of \$11.3 million, which is included in other non-current liabilities in the Consolidated Balance Sheet.

Effective January 1, 2019, the Company adopted ASC 842. In accordance with ASC 842, the Company first determines if an arrangement contains a lease and the classification of that lease, if applicable, at inception. This standard requires the recognition of right-of-use ("ROU") assets and lease liabilities for the Company's operating leases. For contracts with lease and non-lease components, the Company has elected not to allocate the contract consideration, and to account for the lease and non-lease components as a single lease component. The Company has also elected not to recognize a lease liability or ROU asset for leases with a term of 12 months or less, and recognize lease payments for those short-term leases on a straight-line basis over the lease term in the Consolidated Statements of Operations. Operating leases are included in ROU assets, other current liabilities and lease liabilities (net of current portion) in the Consolidated Balance Sheets.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments under the lease. ROU assets and lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. The implicit rate within the Company's leases is generally not determinable and therefore the incremental borrowing rate at the lease commencement date is utilized to determine the present value of lease payments. The determination of the incremental borrowing rate requires judgment. Management determines the incremental borrowing rate for each lease using the Company's estimated borrowing rate, adjusted for various factors including level of collateralization, term and currency to align with the terms of the lease. The ROU asset also includes any lease prepayments, offset by lease incentives. Certain of the Company's leases include options to extend or terminate the lease. An option to extend the lease is considered in connection with determining the ROU asset and lease liability when the Company is reasonably certain that the option will be exercised. An option to terminate is considered unless the Company is reasonably certain the option will not be exercised.

Recently Adopted Accounting Standard Updates

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires that the rights and obligations created by leases with a duration greater than 12 months be recorded as assets and liabilities on the balance sheet of the lessee. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has adopted this standard as of January 1, 2019 using the modified retrospective approach for all leases entered into before the effective date. The Company has also elected the option, as permitted in ASU 2018-11, Leases (Topic 842): Targeted Improvements, whereby initial application of the new lease standard would occur at the adoption date and a cumulative-effect adjustment, if any, would be recognized to the opening balance of retained earnings in the period of adoption. For comparability purposes, the Company will continue to comply with previous disclosure requirements in accordance with existing lease guidance for all periods presented in the year of adoption.

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Notes to Consolidated Financial Statements

(unaudited)

The Company has elected the practical expedients permitted under the transition guidance which enabled the Company: (1) to carry forward the historical lease classification; (2) not to reassess whether expired or existing contracts are or contain leases; and, (3) not to reassess the treatment of initial direct costs for existing leases. In addition, the Company has made an accounting policy election to keep leases with an initial term of 12 months or less off the balance sheet. Upon adoption of this standard on January 1, 2019, the Company recognized a total lease liability in the amount of \$58.0 million, representing the present value of the minimum rental payments remaining as of the adoption date and a right-of-use asset in the amount of \$46.7 million.

Recently Issued Accounting Standard Updates

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments (“ASU 2016-13”). ASU 2016-13 replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses. The ASU is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. Adoption of this guidance is required, prospectively, for annual periods beginning after December 15, 2019, with early adoption permitted for annual periods beginning after December 15, 2018. The Company is evaluating the impact of adopting this new accounting standard on its financial statements.

In August 2018, the FASB issued ASU 2018-13, Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurements (“ASU 2018-13”), which eliminates, adds and modifies certain disclosure requirements for fair value measurements as part of the FASB’s disclosure framework project. Adoption of this guidance is required for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. The Company is evaluating the impact of adopting this new standard on its financial statements.

In August 2018, the FASB issued ASU 2018-15, Customer’s Accounting For Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (“ASU 2018-15”), which aligns the requirements for capitalizing implementation costs in a cloud computing arrangement with the requirements for capitalizing implementation costs incurred for an internal-use software license. Adoption of this guidance is required for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years and early adoption is permitted. Entities are permitted to choose to adopt the new guidance (1) prospectively for eligible costs incurred on or after the date this guidance is first applied or (2) retrospectively. The Company is evaluating the impact of this new accounting standard on its financial statements.

(2) Fair Value Measurements and Other Long-term Investments

Fair Value Measurements

The Company had no assets or liabilities requiring fair value hierarchy disclosures as of March 31, 2019 or December 31, 2018.

Other Fair Value Measurements

Cash, accounts receivable, restricted cash, accounts payable and accrued expenses carrying amounts approximate fair value because of the short-term nature of these instruments. The Company’s non-financial assets, which include property and equipment, intangible assets and goodwill, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required and the Company is required to evaluate the non-financial asset for impairment, a resulting asset impairment would require that the non-financial asset be recorded at fair value.

Other Long-term Investments

Investment in ZCool Technologies Limited (“ZCool”)

On January 4, 2018, the Company invested \$15.0 million in convertible preferred shares issued by ZCool (the “Preferred Shares”), which is equivalent to a 25% fully diluted equity ownership interest. ZCool’s primary business is the operation of an e-commerce platform in China whereby customers can pay to license content contributed by creative professionals. ZCool has been the exclusive distributor of Shutterstock creative content in China since 2014.

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Notes to Consolidated Financial Statements

(unaudited)

ZCool is a variable interest entity that is not consolidated because the Company is not the primary beneficiary. The Preferred Shares are not deemed to be in-substance common stock and will be accounted for using the measurement alternative for equity investments with no readily determinable fair value. The Preferred Shares will be reported at cost, adjusted for impairments or any observable price changes in ordinary transactions with identical or similar investments issued by ZCool. As of March 31, 2019 and December 31, 2018, the Company's total investment in ZCool is approximately \$15.0 million, which is reported within Other assets on the Consolidated Balance Sheet.

(3) Sale of Digital Asset Management Business

On February 26, 2018, the Company completed the Sale of Webdam for an aggregate purchase price of \$49.1 million. Total cash received, net of \$4.6 million transaction costs paid, was \$44.3 million, inclusive of \$2.5 million received during the three months ended March 31, 2019 from the release of funds from escrow. During the three months ended March 31, 2018, the Company recognized a pre-tax gain on sale of approximately \$38.6 million, which represents the excess of the net purchase price over the net assets transferred, less transaction costs.

(4) Property and Equipment

Property and equipment is summarized as follows (in thousands):

	As of March 31, 2019	As of December 31, 2018
Computer equipment and software	\$155,112	\$ 148,104
Furniture and fixtures	10,028	10,020
Leasehold improvements	18,780	18,822
Property and equipment	183,920	176,946
Less accumulated depreciation	(111,367)	(100,758)
Property and equipment, net	\$72,553	\$ 76,188

Depreciation and amortization expense related to property and equipment was \$10.6 million and \$9.5 million for the three months ended March 31, 2019 and 2018, respectively. Depreciation and amortization expense is included in cost of revenue and general and administrative expense in the Consolidated Statements of Operations based on the nature of the asset being depreciated.

Capitalized Internal-Use Software

The Company capitalized costs related to the development of internal-use software of \$6.5 million and \$9.6 million for the three months ended March 31, 2019 and 2018, respectively. Capitalized amounts are included as a component of property and equipment under computer equipment and software on the Consolidated Balance Sheets.

The portion of total depreciation expense related to capitalized internal-use software was \$7.3 million and \$5.4 million for the three months ended March 31, 2019 and 2018, respectively. Depreciation expense related to capitalized internal-use software is included in cost of revenue and general and administrative expense in the Consolidated Statements of Operations.

As of March 31, 2019 and December 31, 2018, the Company had capitalized internal-use software of \$47.4 million and \$48.2 million, respectively, net of accumulated depreciation, which was included in property and equipment, net.

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(5) Goodwill and Intangible Assets

Goodwill

The Company's goodwill balance is attributable to its Bigstock, Editorial, Images and Music reporting units and is tested for impairment annually on October 1 or upon a triggering event. No triggering events were identified during the three months ended March 31, 2019.

The following table summarizes the changes in the carrying value of the Company's goodwill balance during the three months ended March 31, 2019 (in thousands):

	Goodwill
Balance as of December 31, 2018	\$ 88,576
Foreign currency translation adjustment	313
Balance as of March 31, 2019	\$ 88,889

Intangible Assets

Intangible assets consisted of the following as of March 31, 2019 and December 31, 2018 (in thousands):

	As of March 31, 2019			As of December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Life (Years)	Gross Carrying Amount	Accumulated Amortization	
Amortizing intangible assets:						
Customer relationships	\$ 17,649	\$ (7,744)	) 9	\$ 17,360	\$ (7,135))
Trade name	6,455	(3,980)	) 7	6,372	(3,719))
Developed technology	4,838	(3,844)	) 4	4,780	(3,633))
Contributor content	20,572	(5,150)	) 10	19,912	(4,653))
Patents	259	(88)	) 18	259	(84))
Domain name	160	(79)	) 13	160	(79))
Total	\$ 49,933	\$ (20,885)	)	\$ 48,843	\$ (19,303))

Amortization expense was \$1.3 million and \$1.5 million for the three months ended March 31, 2019 and 2018, respectively. The Company determined that there was no indication of impairment of the intangible assets for any period presented. Estimated amortization expense is: \$4.9 million for the remaining nine months of 2019, \$5.9 million in 2020, \$5.1 million in 2021, \$3.4 million in 2022, \$2.8 million in 2023, \$2.7 million in 2024 and \$4.2 million thereafter.

(6) Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	As of March 31, 2019	As of December 31, 2018
Compensation	\$ 13,176	\$ 15,153
Non-income taxes	8,782	7,885
Royalty tax withholdings	5,681	5,618
Other expenses	26,248	22,729
Total accrued expenses	\$ 53,887	\$ 51,385

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(7) Stockholders' Equity and Equity-Based Compensation

Stockholders' Equity

Common Stock

During the three months ended March 31, 2019 and 2018, the Company issued approximately 141,000 and 169,000 shares of common stock, respectively, primarily related to the exercise of stock options and the vesting of Restricted Stock Units ("RSUs").

Treasury Stock

In October 2015, the Company's Board of Directors approved a share repurchase program, authorizing the Company to purchase up to \$100 million of its common stock. In February 2017, the Company's Board of Directors approved an increase to the share repurchase program, authorizing the Company to repurchase up to an additional \$100 million of its outstanding common stock. During the three months ended March 31, 2019 and 2018, the Company did not repurchase any shares of its common stock under the share repurchase program. As of March 31, 2019, the Company had \$100 million of remaining authorization for purchases under the share repurchase program.

The Company expects to fund future repurchases, if any, through a combination of cash on hand, cash generated by operations and future financing transactions, if appropriate. Accordingly, the share repurchase program is subject to the Company having available cash to fund repurchases. Under the program, management is authorized to purchase shares of the Company's common stock from time to time through open market purchases or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to market conditions and other factors.

Equity-Based Compensation

The Company recognizes stock-based compensation expense for all share-based payment awards, including employee stock options and RSUs granted under the 2012 Plan, based on the fair value of each award on the grant date.

The following table summarizes non-cash equity-based compensation expense, net of forfeitures, by financial statement line item included in the accompanying Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Cost of revenue	\$85	\$174
Sales and marketing	582	427
Product development	1,175	1,477
General and administrative	2,782	3,528
Total	\$4,624	\$5,606

The following table summarizes non-cash equity-based compensation expense, net of forfeitures, by award type included in the accompanying Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Stock options	\$891	\$1,466
RSUs	3,733	4,140

Total \$4,624 \$5,606

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Stock Option Awards

During the three months ended March 31, 2019, the Company did not grant any options to purchase shares of its common stock. As of March 31, 2019, there were approximately 429,000 options vested and exercisable with a weighted average exercise price of \$33.94. As of March 31, 2019, the total unrecognized compensation charge related to non-vested options was approximately \$5.9 million, which is expected to be recognized through 2022.

Restricted Stock Unit Awards

During the three months ended March 31, 2019, the Company had net RSU forfeitures, after considering RSU grants, of approximately 52,000. As of March 31, 2019 there are approximately 788,000 non-vested RSUs outstanding with a weighted average grant-date fair value of \$44.67. As of March 31, 2019, the total unrecognized non-cash equity-based compensation charge related to the non-vested RSUs was approximately \$24.0 million, which is expected to be recognized through 2022. On April 1, 2019, the Company granted approximately 365,000 RSUs with a grant date fair value of approximately \$17.0 million.

During the three months ended March 31, 2019, shares of common stock with an aggregate value of \$4.1 million were withheld upon vesting of RSUs and in connection with related remittance of employee withholding taxes to taxing authorities.

Grant of Performance Stock Units (“PSUs”)

On March 26, 2019, the Compensation Committee of the Board of Directors (the “Compensation Committee”) of the Company approved a new form of performance-based stock unit award agreement (the “Form PSU Award Agreement”) under the Company’s Amended and Restated 2012 Omnibus Equity Incentive Plan (the “2012 Plan”). On April 1, 2019, the Company awarded approximately 202,000 target PSUs to certain of the Company’s officers. These awards will be measured against performance goals set by the Compensation Committee for each year during a three-year performance period starting on January 1, 2019, and ending on December 31, 2021.

(8) Revenue

The Company distributes its digital content offerings through two primary channels:

E-commerce: The majority of customers purchase content licenses directly through the Company’s e-commerce platforms. E-commerce customers have the flexibility to purchase a subscription plan that is paid on a monthly or annual basis or to purchase content licenses on a transactional basis. These customers generally license content under the Company’s standard or enhanced licenses, with additional licensing options available to meet customers’ individual needs. E-commerce customers typically pay the full amount of the purchase price in advance or at the time of license, generally with a credit card.

Enterprise: Enterprise customers are mainly composed of creative professionals and large organizations with unique content, licensing and workflow needs. Customers of this size benefit from dedicated sales, service and research teams which provide a number of enhancements to their creative workflows including non-standard licensing rights, multi-seat access, invoicing and the ability to pay on credit terms, increased indemnification protection, multi-brand licensing packages and content licensed for use-cases outside of those available on the e-commerce platform. In addition to the Company’s digital content offerings, the Company has historically generated revenue through other channels:

Other: The Company’s other sales channel includes revenue from Webdam’s digital asset management offerings which included tools to help organizations manage, search, distribute and collaborate on creative and other brand-building activities. Effective February 26, 2018, the Company completed the Sale of Webdam. See Note 3 for further information on the Sale of Webdam.

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The Company's revenue by distribution channel for the three months ended March 31, 2019 and 2018 are as follows (in thousands):

	Three Months Ended March 31,	
	2019	2018
E-commerce	\$98,113	\$89,735
Enterprise	65,219	60,573
Other ⁽¹⁾	—	2,711
Total Revenues	\$163,332	\$153,019

(1) On February 26, 2018, the Company completed the Sale of Webdam. 2018 amounts include revenue earned during the period from January 1, 2018 through February 26, 2018.

The March 31, 2019 deferred revenue balance will be earned as digital content is downloaded or upon the expiration of subscription-based products, and nearly all is expected to be earned within the next twelve months. \$67.3 million of total revenue recognized for the three months ended March 31, 2019 was reflected in deferred revenue as of December 31, 2018.

(9) Other Income, net

The following table presents a summary of the Company's other income and expense activity included in the accompanying Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Foreign currency (loss) / gain	\$(161)	\$319
Interest income	1,057	483
Total other income	\$896	\$802

(10) Income Taxes

The Company's effective tax rates yielded a net expense of 16.4% and 25.8% for the three months ended March 31, 2019 and 2018, respectively. In the three months ended March 31, 2019, the impact of discrete items decreased the effective tax rate for the three months ended March 31, 2019 by 1.2%. In the three months ended March 31, 2018, the Company incurred a discrete tax expense related primarily to the gain on Sale of Webdam, the net effect of which increased the effective tax rate for the three months ended March 31, 2018 by 9.6%.

The Company has computed the provision for income taxes based on the estimated annual effective tax rate and the application of discrete items, if any, in the applicable period. The estimated annual effective tax rate differs from the statutory tax rate due primarily to the international provisions enacted as part of the Tax Cuts and Jobs Act of 2017. During the three months ended March 31, 2019 and 2018, uncertain tax positions recorded by the Company were not material. To the extent the remaining uncertain tax positions are ultimately recognized, the Company's effective tax rate may be impacted in future periods.

The Company recognizes interest expense and tax penalties related to unrecognized tax benefits in income tax expense in the Consolidated Statements of Operations. The Company's accrual for interest and penalties related to unrecognized tax benefits was not material for the three months ended March 31, 2019 and 2018.

During the three months ended March 31, 2019, the Company paid net cash taxes of \$0.3 million and during the three months ended March 31, 2018, the Company received net cash tax refunds of \$1.8 million.

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(11) Net Income Per Share

Basic net income per share is computed using the weighted average number of shares of common stock outstanding for the period, excluding unvested RSUs and stock options. Diluted net income per share is based upon the weighted average shares of common stock outstanding for the period plus dilutive potential shares of common stock, including unvested RSUs and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Net income	\$7,522	\$32,581
Shares used to compute basic net income per share	35,114	34,784
Dilutive potential common shares		
Stock options	105	116
Unvested restricted stock awards	272	418
Shares used to compute diluted net income per share	35,491	35,318
Basic net income per share	\$0.21	\$0.94
Diluted net income per share	\$0.21	\$0.92
Dilutive securities included in the calculation	979	1,425
Anti-dilutive securities excluded from the calculation	1,135	938

(12) Geographic Information

The following table presents the Company's revenue based on customer location (in thousands):

	Three Months Ended March 31,	
	2019	2018
North America	\$57,514	\$56,958
Europe	55,485	51,934
Rest of the world	50,333	44,127
Total revenue	\$163,332	\$153,019

The United States, included in North America in the above table, accounted for 32% and 34% of consolidated revenue for the three months ended March 31, 2019 and 2018, respectively. No other country accounts for more than 10% of the Company's revenue in any period presented.

The Company's long-lived tangible assets were located as follows (in thousands):

	March 31, December 31,	
	2019	2018
North America	\$ 67,440	\$ 71,758
Europe	5,050	4,371
Rest of the world	63	59

Total long-lived tangible assets \$ 72,553 \$ 76,188

The United States, included in North America in the above table, accounted for 86% and 88% of total long-lived tangible assets as of March 31, 2019 and December 31, 2018, respectively. No other country accounts for more than 10% of the Company's long-lived tangible assets in any period presented.

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(13) Leases

The Company's leases relate primarily to office facilities that expire on various dates from 2019 through 2029, some of which include one or more options to renew. All of the Company's leases are classified as operating leases. Operating lease costs, including insignificant costs related to short-term leases, were \$2.7 million and \$2.4 million for the three months ended March 31, 2019 and 2018, respectively.

Additional information related to the Company's leases as of and for the three months ended March 31, 2019, is as follows:

(in thousands, except lease term and discount rate)	March 31, 2019
Balance sheet information	
ROU assets	\$46,313
Lease liabilities, current	\$9,060
Lease liabilities, non-current	48,591
Total lease liabilities	\$57,651
Supplemental data	
Weighted average remaining lease term	9.0 years
Weighted average discount rate	6.2 %
Cash paid for amounts included in lease liabilities	\$2,433
ROU assets obtained in exchange for lease obligations	\$1,160

Maturities of lease liabilities as of March 31, 2019 were as follows:

(in thousands)	March 31, 2019
Year ending December 31,	
2019 (remaining)	\$ 7,386
2020	8,834
2021	7,620
2022	6,957
2023	6,208
Thereafter	39,591
Total undiscounted lease payments	76,596
Less: imputed interest	(18,945)
Total lease liabilities	\$ 57,651

The Company's most significant lease is for its headquarters in New York City, which was entered into in March 2013 and was amended in January 2016 ("ESB Lease"). As amended, the ESB Lease will expire in 2029, and the undiscounted remaining future minimum lease payments are approximately \$66.1 million. The Company is also party to a \$2.6 million letter of credit, as a security deposit for the ESB Lease, which is collateralized by an equivalent amount of cash, and is reported as restricted cash within other assets on the Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018.

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Fiscal year 2018 lease commitments in accordance with prior guidance

Future minimum lease payments under non-cancelable operating leases as of December 31, 2018 were as follows (in thousands):

Year Ending December 31,	Operating Leases
2019	\$ 9,913
2020	8,762
2021	7,493
2022	6,829
2023	6,082
Thereafter	39,481
Total minimum lease payments	\$ 78,560

(14) Commitments and Contingencies

Unconditional purchase obligations and other obligations

As of March 31, 2019, the Company had total other non-lease obligations in the amount of approximately \$71.5 million, which consisted primarily of minimum royalty guarantees and unconditional purchase obligations related to contracts for infrastructure and other business services. As of March 31, 2019, the Company's other obligations for the remainder of 2019 and for the years ending December 31, 2020, 2021, 2022 and 2023 were approximately \$20.5 million, \$30.4 million, \$16.7 million and \$3.9 million, respectively.

Legal Matters

From time to time, the Company may become party to litigation in the ordinary course of business, including direct claims brought by or against the Company with respect to intellectual property, contracts, employment and other matters, as well as claims brought against the Company's customers for whom the Company has a contractual indemnification obligation. The Company assesses the likelihood of any adverse judgments or outcomes with respect to these matters and determines loss contingency assessments on a gross basis after assessing the probability of incurrence of a loss and whether a loss is reasonably estimable. In addition, the Company considers other relevant factors that could impact its ability to reasonably estimate a loss. A determination of the amount of reserves required, if any, for these contingencies is made after analyzing each matter. The Company reviews reserves, if any, at least quarterly and may change the amount of any such reserve in the future due to new developments or changes in strategy in handling these matters. Although the results of litigation and threats of litigation, investigations and claims cannot be predicted with certainty, the Company currently believes that the final outcome of these matters will not have a material adverse effect on its business, consolidated financial position, results of operations, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors. The Company currently has no material active litigation matters and, accordingly, no material reserves related to litigation.

Indemnification and Employment Agreements

In the ordinary course of business, the Company enters into contractual arrangements under which it agrees to provide indemnification of varying scope and terms to customers with respect to certain matters, including, but not limited to, losses arising out of the breach of the Company's intellectual property warranties for damages to the customer directly attributable to the Company's breach. The Company is not responsible for any damages, costs, or losses to the extent such damages, costs or losses arise as a result of the modifications made by the customer, or the context in which an image is used. The standard maximum aggregate obligation and liability to any one customer for all claims is

generally limited to ten thousand dollars. The Company offers certain of its customers greater levels of indemnification, including unlimited indemnification. As of March 31, 2019, the Company had recorded no material liabilities related to indemnification for loss contingencies. Additionally, the Company believes that it has the appropriate insurance coverage in place to adequately cover such indemnification obligations, if necessary.

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Pursuant to the Company's charter documents and separate written indemnification agreements, the Company has certain indemnification obligations to its executive officers, certain employees and directors, as well as certain former officers and directors.

The Company has entered into employment arrangements and indemnification agreements with certain executive officers and with certain employees. The agreements specify various employment-related matters, including annual compensation, performance incentive bonuses, and severance benefits in the event of termination with or without cause.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read together with our interim consolidated unaudited financial statements and related notes contained elsewhere in this Quarterly Report on Form 10-Q and with information contained in our other filings, including the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 filed with the SEC on February 26, 2019.

In addition to historical consolidated financial information, this discussion contains forward-looking statements including statements about our plans, estimates and beliefs. These statements involve risks and uncertainties and our actual results could differ materially from those expressed or implied in forward-looking statements. See "Forward Looking Statements" above. See also the "Risk Factors" disclosure of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 for additional discussion of the risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements.

Overview and Recent Developments

Shutterstock is a global technology company offering a creative platform, which provides high-quality digital content, tools and services to creative professionals. The digital content licensed by our customers includes: (a) imagery, consisting of licensed photographs, vectors, illustrations and video clips which is used in visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content; and (b) music, consisting of high-quality music tracks and sound effects, which is often used to complement digital imagery. We also offered digital asset management services through Webdam, our cloud-based digital asset management service, which we sold in February 2018 ("Sale of Webdam").

Our platform brings together users and contributors of content by providing readily-searchable content that our customers pay to license and by compensating contributors as their content is licensed. For customers seeking specialized content that goes beyond our library of stock content, our platform also connects customers with contributors who can produce custom branded content. More than 1.9 million active, paying customers contributed to our revenue for the twelve-month period ended March 31, 2019. As of March 31, 2019, more than 750,000 approved contributors made their images, video clips and music tracks available in our collection, which has grown to over 260 million images and over 14 million video clips as of March 31, 2019. This makes our collection of content one of the largest of its kind, and we delivered more than 45 million paid downloads across all of our brands during the three months ended March 31, 2019. We believe that we delivered the highest volume of commercial image downloads of any single brand in our industry during this period.

During the three months ended March 31, 2019, in addition to the increase in content provided by our contributors, the Company had the following significant events:

In January 2019, we announced that our contributor-facing website and mobile applications are now available in 21 languages, aligning with the languages already available on the Shutterstock customer-facing site and its new developer portal.

- In January 2019, we launched our first brand marketing campaign in six years. The ‘It’s not stock, it’s Shutterstock’ message is designed to showcase the quality and depth of our creative asset library.
 - In March 2019, we launched in-app contributor registration for the mobile-first generation, making it easier than ever for iOS and Android users to sign up as a Shutterstock contributor.
- Through our platform, we generate revenue by licensing content to our customers. During the three months ended March 31, 2019, 60% of our revenue was generated from e-commerce customers. E-commerce customers have the flexibility of choosing content subscription plans that provide a large volume of content for their creative process without concern for the

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incremental cost of each license. We also offer simple, affordable, smaller subscriptions and those where customers have an option to pay for individual content licenses at the time of delivery. Our enterprise customers generally include creative professionals and larger organizations or those with unique content, licensing and workflow needs. Our dedicated enterprise sales, service and research teams are able to provide a number of enhancements to their creative workflows including non-standard licensing rights, multi-seat access, multi-brand licensing packages and content licensed for use-cases outside of those available for license on our e-commerce platform. Enterprise customers may also benefit from the creation of our custom branded content. Our enterprise customers provided approximately 40% of our revenue during the three months ended in March 31, 2019.

Each time an image, video clip or music track is delivered to a customer for use, we record a royalty expense for the amount due to the associated contributor. Royalties are calculated using either a fixed dollar amount or a fixed percentage of revenue, and are typically paid to contributors on a monthly basis, subject to withholding taxes and certain payout minimums. Royalties represent the largest component of our operating expenses, are reported within cost of revenue, and tend to increase proportionally with revenue.

Our cost of revenue associated with our e-commerce and enterprise customers is substantially similar as a percentage of revenue. While contributors earn a fixed amount per download for some of our products, we have set the per-download amount paid to our contributors for our products so that contributors earn more per download from products where we collect higher revenue per download. In other words, we strive to deliver a similar percentage of revenue to contributors regardless of the sales channel. We do not believe that shifts in the mix between e-commerce and enterprise sales channels will materially impact our operating margins.

An important driver of our growth is customer acquisition, which we achieve primarily through online marketing efforts, including paid search, organic search, online display advertising, email marketing, affiliate marketing, social media and strategic partnerships. Over the past several years, our investments in marketing have represented a significant percentage of revenue. Since we believe the market for content is multi-faceted and continually expanding, we plan to continue to invest aggressively in customer acquisition to achieve revenue and market share growth. We believe that another important driver of growth is the quality of the user experience we provide on our websites, especially the efficiency and speed with which our search interfaces and algorithms help customers find and download the content that they need, the degree to which we make use of the large quantity of data we collect about image, video clip, music and search patterns, and the degree to which our websites have been localized for our global user base. To this end, we have invested aggressively in product development and cloud-based hosting infrastructure, and we intend to continue to invest in these areas, to the extent that we can improve the customer experience and increase the efficiency with which we deploy new products and features. Finally, the number of approved and licensable images in the Shutterstock collection exceeded 260 million images and 14 million video clips as of March 31, 2019, making it one of the largest libraries of its kind.

Key Operating Metrics

In addition to key financial metrics, we regularly review a number of key operating metrics to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe that these metrics can be useful for understanding the underlying trends in our business. The following table summarizes our key operating metrics, which are unaudited, for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,	
	2019	2018
	(in millions, except revenue per download)	
Paid downloads (during the period)	47.2	43.7
Revenue per download (during the period)	\$ 3.42	\$ 3.40
Content in Our Collection (end of period):		
Images	260.5	186.9
Video Clips	14.3	9.9

Paid Downloads

Measuring the number of paid downloads that our customers make in any given period is important because downloads are the primary method of delivering licensed content, which drives a significant portion of our revenue and contributor

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royalties. We define paid downloads as the number of downloads that our customers make in a given period of our photographs, vectors, illustrations, video clips or music tracks. Paid downloads exclude custom content, re-downloads of content that a customer has downloaded in the past (which do not generate incremental revenue or contributor royalty expense) and downloads of content that is offered to customers for no charge, including our free image of the week.

Revenue per Download

We define revenue per download as the amount of revenue recognized in a given period divided by the number of paid downloads in that period excluding revenue from custom content and the impact of revenue that is not derived from or associated with content licenses. This metric captures changes in our pricing, if any, as well as the mix of purchase options that our customers choose, some of which generate more revenue per download than others, and the impact that changes in foreign currency rates have on our pricing. Revenue per download has increased over the last three years, almost entirely due to the introduction of new product offerings and the change in product mix. During this period, pricing has remained relatively constant.

Content in our Collection

We define content in our collection as the total number of (a) images (photographs, vectors and illustrations) and (b) video clips available to customers for commercial license on shutterstock.com at any point in time. We exclude content from this collection metric that is not uploaded directly to our site but is available for license by our customers through an application program interface, custom content and certain content that may be licensed for editorial use only. We record this metric as of the end of a period. Offering a large selection of content allows us to attract and retain customers and, therefore, we believe that continuously broadening our selection of high-quality content is an important driver of our revenue growth.

Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q, including this “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains a calculation of period-over-period revenue growth (including by distribution channel) on a constant-currency basis, which is a financial measure that has not been calculated in accordance with generally accepted accounting principles in the United States, or GAAP, and should be considered in addition to our results prepared in accordance with GAAP and should not be considered as a substitute for, or superior to, our results prepared in accordance with GAAP.

Revenue growth (including by distribution channel) on a constant-currency basis (expressed as a percentage) is calculated by determining the increase in current period revenues over prior period revenues, utilizing fixed exchange rates for translating foreign currency revenues for all periods in the comparison.

Our management uses this non-GAAP financial measure, in conjunction with GAAP financial measures, as an operating measure to help evaluate our business and in making financial and operational decisions. Management believes that providing a measure of period-over-period revenue growth (including by distribution channel) on a constant-currency basis is useful to investors because it enables them to analyze and compare our revenue trends and overall business on the same basis as that which is used by management and because this metric eliminates the effect of foreign currency fluctuations that are not directly attributable to our underlying operating performance and are outside management’s control. Additionally, management believes that providing this non-GAAP financial measure enhances the comparability for investors in assessing our financial reporting. However, we caution investors that non-GAAP financial information, by its nature, departs from traditional accounting conventions, and similarly-titled non-GAAP financial measures vary among companies. Accordingly, its use can make it difficult to compare our current results with our results from other reporting periods and with the results of other companies.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with GAAP. The preparation of the consolidated financial statements in conformity with GAAP requires our management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure or inclusion of contingent assets and liabilities, the disclosure or inclusion of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. We evaluate our significant estimates on an ongoing

basis, including, but not limited to, estimates related to allowance for doubtful accounts, the volume of expected unused licenses for our subscription-based products, goodwill, intangibles, equity-based compensation and income tax provisions. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

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We believe that the policies, assumptions and estimates associated with our revenue recognition, allowance for doubtful accounts, equity-based compensation, accounting for income taxes and goodwill and intangible assets have the greatest potential impact on our financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

A description of our critical accounting policies that involve significant management judgments appears in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 that was filed with the SEC on February 26, 2019, or the 2018 Form 10-K, under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates.”

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires that the rights and obligations created by leases with a duration greater than 12 months be recorded as assets and liabilities on the balance sheet of the lessee. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has adopted this standard as of January 1, 2019 using the modified retrospective approach for all leases entered into before the effective date. The Company has also elected the option, as permitted in ASU 2018-11, Leases (Topic 842): Targeted Improvements, whereby initial application of the new leases standard would occur at the adoption date and a cumulative-effect adjustment would be recognized to the opening balance of retained earnings in the period of adoption. For comparability purposes, the Company will continue to comply with existing disclosure requirements in accordance with existing lease guidance for all periods presented in the year of adoption.

Effective January 1, 2019, we adopted the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update (“ASU”) 2016-02, Leases (Topic 842) using a modified retrospective approach and, accordingly, balance sheet and income statement totals for all periods before January 1, 2019 reflect those previously reported under the prior accounting model and have not been restated.

See Note 1 to our Unaudited Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for a full description of the impact of the adoption of new accounting standards on our financial statements. Apart from the items described above, there have been no material changes to our critical accounting policies and estimates as compared to our critical accounting policies and estimates included in the 2018 Form 10-K. Key Components of Our Results of Operations

Revenue

We distribute our digital content offerings through two primary channels:

E-commerce: The majority of customers license content directly through our e-commerce platforms. E-commerce customers have the flexibility to purchase a subscription-based plan that is paid on a monthly or annual basis or to license content on a transactional basis. These customers generally license content under our standard or enhanced licenses, with additional licensing options available to meet customers’ individual needs. E-commerce customers typically pay the full amount of the purchase price in advance or at the time of license, generally with a credit card.

Enterprise: Our base of enterprise customers is mainly composed of creative professionals and large organizations with unique content, licensing and workflow needs. As our enterprise customer base has grown, the number of unique offerings has also grown, as we continue to address individual business needs. Customers of this size benefit from communication with our dedicated sales, service and research teams which provide a number of tailored enhancements to their creative workflows including non-standard licensing rights, multi-seat access, ability to pay on credit terms, multi-brand licensing packages, increased indemnification protection and content licensed for use-cases outside of those available on the e-commerce platform.

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In addition to these digital content offerings, we have historically generated revenue through other channels:

Other: Our other sales channel includes revenue from Webdam's digital asset management offerings which included tools to help organizations manage, search, distribute and collaborate on creative and other brand-building activities.

On February 26, 2018, we completed the Sale of Webdam for an aggregate purchase price of \$49.1 million.

The Company's revenues by distribution channel for the three months ended March 31, 2019 and 2018 are as follows (in thousands):

	Three Months Ended March 31,	
	2019	2017
E-Commerce	\$98,113	\$89,735
Enterprise	65,219	60,573
Other ⁽¹⁾	—	2,711
Total Revenues	\$163,332	\$153,019

(1) On February 26, 2018, we completed the Sale of Webdam. Consequently, 2018 includes revenues earned during the period January 1, 2018 through February 26, 2018.

Costs and Expenses

Cost of Revenue. Cost of revenue includes royalties paid to contributors, credit card processing fees, content review costs, customer service expenses, infrastructure and hosting costs related to maintaining our creative platform and cloud-based software platform, amortization of content and technology intangible assets, allocated facility costs and other supporting overhead costs. Cost of revenue also includes employee compensation, including non-cash equity-based compensation, bonuses and benefits associated with infrastructure and hosting costs related to maintaining our creative platform and cloud-based software platform. We expect that our cost of revenue will increase in absolute dollars in the foreseeable future to the extent that our revenue grows.

Sales and Marketing. Sales and marketing expenses include third-party marketing, advertising, branding, public relations and sales expenses. Sales and marketing expenses also include associated employee compensation, including non-cash equity-based compensation, bonuses and benefits, and commissions as well as allocated facility and other supporting overhead costs. We expect sales and marketing expenses to increase in absolute dollars in the foreseeable future as we continue to invest in new customer acquisition.

Product Development. Product development expenses consist of employee compensation, including non-cash equity-based compensation, bonuses and benefits, and expenses related to vendors engaged in product management, design, development and testing of our websites and products. Product development costs also include allocated facility and other supporting overhead costs. We expense product development costs as incurred, except for costs that are capitalized related to internal-use software development projects and subsequently depreciated over the expected useful life of the developed software. We expect product development expenses, of which a portion will be capitalized, to continue in the foreseeable future as we identify opportunities to invest in the development of new products and internal tools and enhancement of our existing products and technologies that we believe will drive the long-term profitability of the business.

General and Administrative. General and administrative expenses include employee compensation, including non-cash equity-based compensation, bonuses and benefits for executive, finance, business development, accounting, legal, human resources, internal information technology, business intelligence and other administrative personnel. In addition, general and administrative expenses include outside legal, tax and accounting services, bad debt expense, insurance, facilities costs and other supporting overhead costs. We expect to incur incremental general and administrative expenses to support our global operational growth and enhancements to support our reporting and planning functions.

Other Income, net. Other income, net consists of non-operating costs such as foreign currency transaction gains and losses, interest income and expense, impairments related to a long-term investment asset, and prior to 2017, changes in the fair value of contingent consideration related to acquisitions. As we increase the volume of business transacted in foreign currencies resulting from international expansion and as currency rates fluctuate, we expect foreign

currency gains and losses to continue to fluctuate.

Income Taxes. We compute income taxes using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted statutory income tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized. As of March 31, 2019, we have not recorded any such valuation allowances.

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As we continue to expand our operations outside of the United States, we have been and may continue to become subject to taxation in additional non-U.S. jurisdictions and our effective tax rate could fluctuate accordingly.

Results of Operations

The following table presents our results of operations for the periods indicated. The period-to-period comparisons of results are not necessarily indicative of results for future periods.

	Three Months Ended March 31, 2019 2018 (in thousands)	
Consolidated Statements of Operations:		
Revenue	\$163,332	\$153,019
Operating expenses:		
Cost of revenue	69,218	64,490
Sales and marketing	44,446	40,368
Product development	14,986	16,448
General and administrative	26,583	27,224
Total operating expenses	155,233	148,530
Income from operations	8,099	4,489
Gain on Sale of Webdam	—	38,613
Other income, net	896	802
Income before taxes	8,995	43,904
Provision for income taxes	1,473	11,323
Net income	\$7,522	\$32,581

The following table presents the components of our results of operations for the periods indicated as a percentage of revenue:

	Three Months Ended March 31, 2019 2018	
Consolidated Statements of Operations:		
Revenue	100%	100%
Operating expenses:		
Cost of revenue	42 %	42 %
Sales and marketing	27 %	26 %
Product development	9 %	11 %
General and administrative	16 %	18 %
Total operating expenses	95 %	97 %
Income from operations	5 %	3 %
Gain on Sale of Webdam	— %	25 %
Other income, net	1 %	1 %
Income before taxes	6 %	29 %
Provision for income taxes	1 %	7 %
Net income	5 %	21 %

Note: Percent totals may not sum exactly, due to rounding

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Comparison of the Three Months Ended March 31, 2019 and 2018

The following table presents our results of operations for the periods indicated:

	Three Months Ended March 31,			
	2019	2018	\$ Change	% Change
(in thousands)				
Consolidated Statements of Operations:				
Revenue	\$ 163,332	\$ 153,019	\$ 10,313	6.7 %
Operating expenses:				
Cost of revenue	69,218	64,490	4,728	7.3
Sales and marketing	44,446	40,368	4,078	10.1
Product development	14,986	16,448	(1,462)	(8.9)
General and administrative	26,583	27,224	(641)	(2.4)
Total operating expenses	155,233	148,530	6,703	4.5
Income from operations	8,099	4,489	3,610	80.4
Gain on Sale of Webdam	—	38,613	(38,613)	*
Other income, net	896	802	94	*
Income before income taxes	8,995	43,904	(34,909)	(79.5)
Provision for income taxes	1,473	11,323	(9,850)	*
Net income	\$ 7,522	\$ 32,581	\$ (25,059)	(76.9)%

* Percentage change is not meaningful

Revenue

Revenue increased by \$10.3 million, or 6.7%, to \$163.3 million in the three months ended March 31, 2019 compared to the same period in 2018. Excluding the impact of foreign currency fluctuations, revenue increased 9.1% in the three months ended March 31, 2019, compared to the same period in 2018. In addition, the Company's e-commerce and enterprise revenues increased by 9.3% and 7.7%, respectively, in the three months ended March 31, 2019, compared to the same period in 2018. On a constant currency basis, the Company's e-commerce and enterprise revenues increased by 11.6% and 10.4%, respectively, in the three months ended March 31, 2019, compared to the same period in 2018.

During the three months ended March 31, 2019, we continued to grow our customer base and continued with initiatives focused on broadening our product offerings and adding functionality to our creative platform and increased sales and marketing efforts to attract more users and promote increased customer engagement across our platform. We believe these actions and initiatives will lead to increased and sustained customer engagement in the future. The increased revenue was partially offset by the absence of revenue from Webdam during the quarter, as a result of the Sale of Webdam in February 2018. We did not recognize revenue from Webdam in the three months ended March 31, 2019, compared to \$2.7 million for the three months ended March 31, 2018.

In the three months ended March 31, 2019 and 2018, we delivered 47.2 million and 43.7 million paid downloads, respectively, and our revenue per download increased to \$3.42 for the three months ended March 31, 2019 from \$3.40 for the three months ended March 31, 2018.

Our revenue growth by region was as follows: revenue from outside Europe and North America increased by \$6.2 million, or 14.1%, to \$50.3 million, revenue from Europe increased by \$3.6 million, or 6.8%, to \$55.5 million and revenue from North America increased by \$0.6 million, or 1.0%, to \$57.5 million in the three months ended March 31, 2019 compared to the same period in 2018.

Costs and Expenses

Cost of Revenue. Cost of revenue increased by \$4.7 million, or 7.3%, to \$69.2 million in the three months ended March 31, 2019 compared to the same period in 2018. Royalties expense, which is driven in large part by the number of downloads and the revenue earned on each download, increased \$2.6 million, or 6.3%, which is in line with the increase in revenues for the three months ended March 31, 2019. We anticipate royalties will continue growing in

absolute dollars as long as revenue grows, although royalties as a percentage of revenue may vary somewhat from period to period as a result of further

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shifts in customer usage and product mix. Costs associated with website hosting, hardware and software licenses, and depreciation and amortization expense increased by \$1.9 million to \$14.7 million for the three months ended March 31, 2019 compared to the same period in 2018, driven primarily by the depreciation and amortization of infrastructure, hardware and software assets acquired, developed and purchased in recent periods.

Sales and Marketing. Sales and marketing expenses increased by \$4.1 million, or 10.1%, to \$44.4 million in the three months ended March 31, 2019 compared to the same period in 2018. Expenses related to performance and brand advertising, the largest component of our sales and marketing expenses, increased by \$3.7 million, as compared to the prior year, as a result of increased spending on affiliate, search advertising and other new channels and are in line with the increase in revenues for the three months ended March 31, 2019. We anticipate that our total sales and marketing spend will continue to increase in absolute dollars for the foreseeable future as we continue to pursue growth through new customers, products, markets and geographies.

Product Development. Product development expenses decreased by \$1.5 million, or 8.9%, from \$16.4 million for the three months ended March 31, 2018 to \$15.0 million for the three months ended March 31, 2019. This decrease was driven by an approximately \$4.0 million reduction in employee related costs, net of capitalized labor. The decline was partially offset by an increase of \$2.5 million in software and other technology used to support our product development initiatives for the three months ended March 31, 2019, as compared to the prior year. We anticipate this level of product development expenses, of which a portion will continue to be capitalized, to continue for the foreseeable future as we continue to invest in developing new products and internal tools and enhancing the functionality of our existing products and technology.

General and Administrative. General and administrative expenses decreased by \$0.6 million, or 2.4%, to \$26.6 million in the three months ended March 31, 2019 compared to the same period in 2018. The change was driven by a reduction in bad debt expense for the three months ended March 31, 2019.

Gain on Sale of Webdam. On February 26, 2018, the Company completed the Sale of Webdam, for an aggregate purchase price of \$49.1 million. Total cash received, net of \$4.6 million in transaction costs paid, was \$44.3 million, inclusive of \$2.5 million received from the release of funds from escrow during the three months ended March 31, 2019. During the three months ended March 31, 2018, management recognized a pre-tax gain on the sale of approximately \$38.6 million, which represents the excess of the net purchase price over the net assets transferred, less transaction costs.

Other Income, net. In the three months ended March 31, 2019, approximately \$1.1 million of other income consisted of interest income which was partially offset by \$0.2 million of unfavorable foreign exchange fluctuations. During the three months ended March 31, 2018, approximately \$0.5 million of other income consisted of interest income and approximately \$0.3 million consisted of favorable foreign exchange fluctuations.

Income Taxes. Income tax expense decreased by \$9.9 million for the three months ended March 31, 2019 as compared to the same period in 2018. Our effective tax rates yielded an expense of 16.4% and 25.8% for the three months ended March 31, 2019 and 2018, respectively.

For the three months ended March 31, 2018, we incurred a net discrete tax expense related primarily to the gain on Sale of Webdam, the effect of which increased the effective tax rate by 9.6%. Excluding the discrete items, our effective tax rate would have been 16.2% for the three months ended March 31, 2018.

Quarterly Trends

Our operating results may fluctuate from quarter to quarter as a result of a variety of factors, including the effects of some seasonal trends in customer behavior. For example, we expect certain customers' usage may decrease during the fourth quarter of each calendar year due to the year-end holiday vacation season and may increase in the first quarter of each calendar year as many customers return to work. While we believe seasonal trends have affected and will continue to affect our quarterly results, our growth trajectory may have overshadowed these effects to date.

Additionally, because a significant portion of our revenue is derived from repeat customers who have purchased subscription plans, our revenues tend to be smoother and less volatile than if we had no subscription-based customers. In addition, expenditures on digital content by customers tend to be discretionary in nature, reflecting overall economic conditions, the economic prospects of specific industries, budgeting constraints, buying patterns and a

variety of other factors, many of which are outside our control. As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indicators of our future operating performance.

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Liquidity and Capital Resources

As of March 31, 2019, we had cash and cash equivalents totaling \$240.1 million which primarily consisted of bank balances and money market mutual funds. Since inception, we have financed our operations primarily through cash flows generated from operations.

Historically, our principal uses of cash have been funding our operations, capital expenditures, content acquisition, business combinations that enhance our strategic position and share purchases under our share repurchase program. We plan to finance our operations and capital expenses largely through cash generated by our operations. Since our results of operations are sensitive to the level of competition we face, increased competition could adversely affect our liquidity and capital resources.

Sale of Webdam

On February 26, 2018, we completed the Sale of Webdam for an aggregate purchase price of \$49.1 million. Total cash received, net of \$4.6 million in transaction costs paid, was \$44.3 million, inclusive of \$2.5 million received from the release of funds from escrow during the three months ended March 31, 2019. We recognized a pre-tax gain on sale of approximately \$38.6 million, which represents the excess of the net purchase price over the net assets transferred, less transaction costs.

Share Repurchase Program

In October 2015, our Board of Directors approved a share repurchase program, authorizing us to repurchase up to \$100 million of our common stock, and in February 2017, our Board of Directors approved an increase to the share repurchase program, authorizing us to repurchase up to an additional \$100 million of our outstanding common stock. We expect to fund future repurchases, if any, through a combination of cash on hand, cash generated by operations and future financing transactions, if appropriate. Accordingly, our share repurchase program is subject to us having available cash to fund repurchases. Under this program, management is authorized to purchase shares of our common stock from time to time through open market purchases or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to market conditions and other factors.

As of March 31, 2019, we have repurchased approximately 2,558,000 shares of our common stock under the share repurchase program at an average per-share cost of \$39.09. During the three months ended March 31, 2019, we did not repurchase any shares of our common stock under the share repurchase program. As of March 31, 2019, we had \$100 million of remaining authorization for share repurchases under this program.

Share-Based Compensation

Effective October 1, 2016, we implemented a practice of net share settlement upon the vesting of restricted stock units (“RSUs”) to cover any required withholding taxes by retaining the number of shares with a value equal to the amount of the tax and remitting an equal amount of cash to the appropriate taxing authorities, rather than our previous approach of requiring employees to sell a portion of the shares that they receive upon vesting to fund the required withholding taxes (“sell-to-cover”). The net share settlement approach has increased our cash outflows compared to the cash outflows under the sell-to-cover approach. In addition, as compared to the sell-to-cover approach, net share settlement has resulted in fewer shares being issued into the market as employees’ RSUs vest, thereby reducing the dilutive impact of our share-based compensation programs on stockholders.

During the three months ended March 31, 2019, shares with an aggregate value of \$4.1 million were withheld upon vesting of RSUs and in connection with related remittance to taxing authorities.

Sources and Uses of Funds

We believe, based on our current operating plan, that our cash and cash equivalents, and cash from operations, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Consistent with previous periods, we expect that future capital expenditures will primarily relate to building enhancements to the functionality of our current platform, the acquisition of additional storage, servers, network connectivity hardware, security apparatus and software, leasehold improvements and furniture and fixtures related to office expansion and relocation, digital content and general corporate infrastructure. See Note 14 to our Unaudited Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for information regarding existing capital commitments as of March 31, 2019.

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Cash Flows

The following table summarizes our cash flow data for the three months ended March 31, 2019 and 2018 (in thousands).

	Three Months Ended March 31,	
	2019	2018
Net cash provided by operating activities	\$19,709	\$21,094
Net cash (used in) / provided by investing activities	\$(5,298)	\$10,917
Net cash used in financing activities	\$(3,876)	\$(2,848)

Operating Activities

Our primary source of cash from operating activities is cash collections from our customers. The majority of our revenue is generated from credit card transactions and is typically settled within one to five business days. Our primary uses of cash for operating activities are for the payment of royalties to content contributors, employee-related expenditures and the payment of other operating expenses incurred in the ordinary course of business.

Net cash provided by operating activities was \$19.7 million for the three months ended March 31, 2019, compared to \$21.1 million for the three months ended March 31, 2018. In the three months ended March 31, 2019, operating cash flows were unfavorably impacted by changes in the timing of payments pertaining to operating expenses, which can cause operating cash flow to fluctuate from period to period. In addition, as it relates to cash taxes, the Company paid net cash taxes of \$0.3 million for the three months ended March 31, 2019, and during the three months ended March 31, 2018, the Company received net cash tax refunds of \$1.8 million.

Investing Activities

Cash used in investing activities for the three months ended March 31, 2019 was \$5.3 million, consisting primarily of capital expenditures of \$7.3 million for internal-use software and website development costs and purchases of software and equipment, partially offset by \$2.5 million of cash received during the three months ended March 31, 2019 from escrowed funds related to the Sale of Webdam.

Cash provided by investing activities in the three months ended March 31, 2018 was \$10.9 million, consisting primarily of cash received related to the Sale of Webdam, of approximately \$42.3 million, which was partially offset by capital expenditures of \$15.0 million to purchase software and equipment related to our data centers, capitalization of leasehold improvements and website development costs, \$15.0 million related to our investment in Zcool, \$0.8 million paid in settlement of final working capital obligations related to the 2017 acquisition of Flashstock and \$0.6 million paid to acquire the rights to distribute certain digital content in perpetuity.

Financing Activities

Cash used in financing activities in the three months ended March 31, 2019 was \$3.9 million, consisting primarily of \$4.1 million, which was paid in settlement of tax withholding obligations related to employee stock-based compensation awards. These amounts were partially offset by proceeds of approximately \$0.2 million from the issuance of common stock in connection with the exercise of stock options.

Cash used in financing activities in the three months ended March 31, 2018 was \$2.8 million, consisting primarily of \$4.0 million which was paid in settlement of tax withholding obligations related to employee stock-based compensation awards, and was partially offset by approximately \$1.2 million of proceeds from the issuance of common stock in connection with the exercise of stock options.

Contractual Obligations and Commitments

We lease real estate under operating lease agreements that expire on various dates during the period from 2019 through 2029. We do not have any material finance lease obligations and our property, equipment and software have been purchased primarily with cash. We anticipate expanding our office and co-location facilities as our revenue and customer base continue to grow and diversify. We do not anticipate any difficulties in renewing those leases and co-location agreements that expire within the next several years and that we currently plan to renew, or in leasing other space or hosting facilities, if required.

On March 21, 2013, we entered into an operating lease agreement to lease our headquarters in New York City, which was amended in 2016. The aggregate future minimum lease payments under the lease, as amended, are approximately \$66.1 million. We are also party to a letter of credit as a security deposit for this leased facility, which was increased to \$2.6 million in January 2016 in connection with an amendment of the lease. As of March 31, 2019, the letter of credit is

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collateralized by \$2.6 million of cash, which is reported as restricted cash and is included in other assets on our Consolidated Balance Sheet as of March 31, 2019.

Additionally, as of March 31, 2019, aggregate future minimum lease payments under other operating leases are approximately \$17.0 million.

We enter into unconditional purchase obligations related to contracts for cloud-based services, infrastructure and other business services as well as minimum royalty guarantees in connection with certain content licenses. As of March 31, 2019, our guaranteed royalty payments and unconditional purchase obligations for the remainder of 2019 and for the fiscal years ending December 31, 2020, 2021 and 2022 were approximately \$20.5 million, \$30.4 million, \$16.7 million and \$3.9 million, respectively.

Off-Balance Sheet Arrangements

As of March 31, 2019, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to market risks in the ordinary course of our business, including risks related to foreign currency exchange rate fluctuation, interest rate fluctuation and inflation.

Foreign Currency Exchange Risk

Our sales to international customers are denominated in multiple currencies, including but not limited to the U.S. dollar, the euro, the British pound, the Australian dollar and the Japanese yen. Revenue denominated in foreign currencies as a percentage of total revenue was approximately 35% and 37% for the three months ended March 31, 2019 and 2018, respectively. Changes in exchange rates will affect our revenue and certain operating expenses to the extent that our revenue is generated and expenses are incurred in currencies other than the U.S. dollar. All amounts earned by and paid to our foreign contributors are denominated in the U.S. dollar and will not be affected by changes in exchange rates. Based on our foreign currency denominated revenue for the three months ended March 31, 2019, we estimate that a 10% change in the exchange rate of the U.S. dollar against all foreign currency denominated revenues would result in an approximately 3% impact on our revenue.

We have established foreign subsidiaries in various countries and have concluded that the functional currency of these entities is generally the local currency. Business transacted in currencies other than each entity's functional currency results in transactional gains and losses. Translation adjustments resulting from converting the foreign subsidiaries' financial statements into U.S. dollars are recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity. We do not currently enter into derivatives or other financial instruments in order to hedge our foreign currency exchange risk, but we may do so in the future.

Our historical revenue by currency is as follows (in thousands):

	Three Months Ended March 31,			
	2019		2018	
	U.S. Dollars	Originating Currency	U.S. Dollars	Originating Currency
Euro	\$33,075	€ 28,671	\$31,383	€ 25,545
British pounds	12,114	£ 9,256	13,775	£ 9,906
All other non-U.S. currencies ⁽¹⁾	11,761		10,792	
Total foreign currency	56,950		55,950	
U.S. dollar	106,382		97,069	
Total revenue	\$163,332		\$153,019	

(1) Includes no single currency which exceeded 5% of total revenue for any of the periods presented.

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Interest Rate Fluctuation Risk

Our cash and cash equivalents consist of cash and money market accounts. The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. The fair value of our cash and cash equivalents is not particularly sensitive to interest rate changes.

We did not have any long-term borrowings as of March 31, 2019.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2019. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. However, any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objective.

Based on the evaluation of our disclosure controls and procedures as of March 31, 2019, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were not effective at the reasonable assurance level due to a material weakness in our internal control over financial reporting. We concluded that we did not design and maintain effective controls related to the accuracy, cut-off and completeness of sales transactions related to certain enterprise license arrangements. Specifically, as our business strategy related to enterprise license arrangements changed during 2018, we did not design and maintain effective controls to assess the risks of misstatement, and therefore the appropriateness of revenue recognition, associated with product offerings outside of our standard product catalog. The deficiencies resulted in immaterial errors in recorded revenue, accounts receivable, deferred revenue and related disclosures for the years ended December 31, 2018 and 2017 and the interim periods ended June 30, 2018 and September 30, 2018 and did not result in a material misstatement of our interim or annual consolidated financial statements or disclosures for any historical periods. Additionally, these control deficiencies could result in a misstatement of the aforementioned account balances or disclosures that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that these control deficiencies constitute a material weakness. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

Remediation Plan

The Board of Directors and management are fully committed to maintaining a strong internal control environment. In response to the identified material weakness, management, with the oversight of the Audit Committee of the Board of Directors, has taken comprehensive actions to remediate the material weakness in internal control over financial reporting. These actions include the: (1) creation of a project team to identify the population of enterprise product offerings outside of our standard product catalog; and (2) development and implementation of an enhanced process, focused on the accuracy, cut-off and completeness of transactions related to these enterprise product offerings.

We believe the remediation steps outlined above will improve the effectiveness of our internal control over financial reporting. However, the material weakness will not be considered remediated until a sustained period of time has passed to allow management to test the design and operational effectiveness of the corrective actions.

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Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Although we are not currently a party to any material active litigation, from time to time, third parties assert claims against us regarding intellectual property rights, employment matters, privacy issues and other matters arising during the ordinary course of business. Although we cannot be certain of the outcome of any litigation or the disposition of any claims, nor the amount of damages and exposure, if any, that we could incur, we currently believe that the final disposition of all existing matters will not have a material adverse effect on our business, results of operations, financial condition or cash flows. In addition, in the ordinary course of our business, we are also subject to periodic threats of lawsuits, investigations and claims. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

Item 1A. Risk Factors.

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our 2018 Form 10-K, which could materially affect our business, financial condition or future results. During the three months ended March 31, 2019, there were no material changes to these risk factors as described in our 2018 Form 10-K.

Item 6. Exhibits.

See the Exhibit Index, which immediately precedes the signature page of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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EXHIBIT INDEX

Exhibit

Number Exhibit Description

10.1#	<u>Employment Agreement, dated March 13, 2019 between the Company and Stan Pavlovsky</u>
10.2#	<u>Form of Performance Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 27, 2019 (File No. 001-35669))</u>
31.1#	<u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2#	<u>Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32#	<u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHUTTERSTOCK, INC.

Dated: April 25, 2019 By: /s/ Steven Berns

Steven Berns

Co-Chief Operating Officer and Chief Financial Officer

(Principal Financial Officer)

Dated: April 25, 2019 By: /s/ Steven Ciardiello

Steven Ciardiello

Chief Accounting Officer

(Principal Accounting Officer)