
**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 September 30, 2018

OR

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

For the transition period from _____ to _____

Commission file number: 001-35264

CARBONITE, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation)

33-1111329
(I.R.S. Employer
Identification No.)

Two Avenue de Lafayette, Boston, Massachusetts 02111
(Address of principal executive offices, including ZIP code)

(617) 587-1100
(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. (Check one):

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

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

As of October 31, 2018, there were 34,557,930 shares of the registrant's Common Stock, par value \$0.01 per share, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Carbonite, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

September 30, 2018 **December 31,**
2017

(in thousands, except share data)

ASSETS		
Current assets:		
Cash and cash equivalents	\$ 200,981	\$ 128,231
Trade accounts receivable, less allowances for doubtful accounts of \$1,758 and \$994	32,582	22,219
Prepaid expenses and other current assets	10,059	6,823
Total current assets	243,622	157,273
Property and equipment, net	35,436	28,790
Other assets	13,072	804
Acquired intangible assets, net	126,501	44,994
Goodwill	155,258	80,958
Total assets	\$ 573,889	\$ 312,819
LIABILITIES, TEMPORARY EQUITY AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 4,074	\$ 10,842
Accrued compensation	9,398	9,892
Accrued expenses and other current liabilities	15,848	11,783
Short-term debt	116,640	—
Current portion of deferred revenue	121,270	100,241
Total current liabilities	267,230	132,758
Long-term debt	—	111,819
Deferred revenue, net of current portion	28,044	24,273
Other long-term liabilities	5,686	5,704
Total liabilities	300,960	274,554
Commitments and contingencies (Note 12)		
Temporary equity	27,110	—
Stockholders' equity:		
Preferred stock, \$0.01 par value; 6,000,000 shares authorized; no shares issued	—	—
Common stock, \$0.01 par value; 45,000,000 shares authorized; 36,504,894 shares issued and 34,549,722 shares outstanding at September 30, 2018; 30,130,856 shares issued and 28,182,094 shares outstanding at December 31, 2017	365	301
Additional paid-in capital	420,383	233,343
Treasury stock, at cost (1,955,172 and 1,948,762 shares as of September 30, 2018 and December 31, 2017, respectively)	(27,837)	(26,616)
Accumulated other comprehensive income	1,529	581
Accumulated deficit	(148,621)	(169,344)
Total stockholders' equity	245,819	38,265
Total liabilities, temporary equity and stockholders' equity	\$ 573,889	\$ 312,819

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

Carbonite, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands, except share and per share amounts)			
Revenue:				
Services	\$ 70,290	\$ 52,966	\$ 193,678	\$ 154,131
Product	7,392	8,671	25,764	23,639
Total revenue	77,682	61,637	219,442	177,770
Cost of revenue:				
Services	17,094	14,627	50,782	45,176
Product	417	760	1,348	2,127
Amortization of intangible assets	4,317	2,203	11,067	5,953
Total cost of revenue	21,828	17,590	63,197	53,256
Gross profit	55,854	44,047	156,245	124,514
Operating expenses:				
Research and development	14,914	12,781	43,152	34,035
General and administrative	11,159	9,676	39,079	33,399
Sales and marketing	21,184	22,131	63,130	68,165
Amortization of intangible assets	3,924	553	8,515	1,535
Restructuring charges	357	—	1,260	—
Total operating expenses	51,538	45,141	155,136	137,134
Income (loss) from operations	4,316	(1,094)	1,109	(12,620)
Interest expense	(2,873)	(2,416)	(8,894)	(5,011)
Interest income	390	210	803	364
Other (expense) income, net	(147)	(66)	48	1,129
Income (loss) before income taxes	1,686	(3,366)	(6,934)	(16,138)
Provision (benefit) for income taxes	1,100	237	(13,777)	(13,750)
Net income (loss)	\$ 586	\$ (3,603)	\$ 6,843	\$ (2,388)
Net income (loss) per common share:				
Basic	\$ 0.02	\$ (0.13)	\$ 0.23	\$ (0.09)
Diluted	\$ 0.02	\$ (0.13)	\$ 0.21	\$ (0.09)
Weighted-average number of common share outstanding:				
Basic	32,876,529	27,795,858	29,965,390	27,714,273
Diluted	36,454,443	27,795,858	32,762,302	27,714,273

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

Carbonite, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(in thousands)			
Net income (loss)	\$ 586	\$ (3,603)	\$ 6,843	\$ (2,388)
Other comprehensive income (loss):				
Foreign currency translation adjustments	438	(644)	948	(2,311)
Total other comprehensive income (loss)	438	(644)	948	(2,311)
Total comprehensive income (loss)	<u>\$ 1,024</u>	<u>\$ (4,247)</u>	<u>\$ 7,791</u>	<u>\$ (4,699)</u>

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

Carbonite, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Operating activities		
Net income (loss)	\$ 6,843	\$ (2,388)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,622	16,039
Amortization of deferred costs	1,521	—
Gain on disposal of equipment	(245)	(893)
Impairment of capitalized software	653	906
Stock-based compensation expense	13,461	9,220
Benefit for deferred income taxes	(16,228)	(15,054)
Non-cash interest expense related to amortization of debt discount	4,712	2,943
Other non-cash items, net	136	(367)
Changes in assets and liabilities:		
Accounts receivable	(7,001)	510
Prepaid expenses and other current assets	(2,281)	806
Other assets	(4,655)	(209)
Accounts payable	(5,811)	346
Accrued expenses and other current liabilities	3,341	(2,153)
Other long-term liabilities	(38)	32
Deferred revenue	9,784	7,593
Net cash provided by operating activities	33,814	17,331
Investing activities		
Purchases of property and equipment	(9,927)	(11,944)
Proceeds from sale of property and equipment and businesses	657	1,231
Proceeds from maturities of derivatives	2,596	370
Purchases of derivatives	(1,403)	(4,829)
Payment for intangibles	(5,750)	—
Payment for acquisition, net of cash acquired	(144,597)	(69,798)
Net cash used in investing activities	(158,424)	(84,970)
Financing activities		
Proceeds from exercise of stock options	1,139	4,158
Proceeds from issuance of common stock for secondary offering	199,302	—
Proceeds from issuance of treasury stock under employee stock purchase plan	1,215	—
Payments of withholding taxes in connection with restricted stock unit vesting	(2,154)	(1,504)
Proceeds from long-term borrowings, net of debt issuance costs	88,068	177,797
Payments on long-term borrowings	(90,000)	(39,200)
Repurchase of common stock	—	(14,964)
Net cash provided by financing activities	197,570	126,287
Effect of currency exchange rate changes on cash	(210)	1,490
Net increase in cash, cash equivalents and restricted cash	72,750	60,138
Cash, cash equivalents and restricted cash, beginning of period	128,231	59,287
Cash, cash equivalents and restricted cash, end of period	\$ 200,981	\$ 119,425

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

Carbonite, Inc.
Condensed Consolidated Statements of Cash Flows (Continued)
(Unaudited)

Supplemental disclosure of cash flow information

Cash paid for income taxes	\$ 292	\$ 917
Cash paid for interest	\$ 2,965	\$ —

Supplemental disclosure of non-cash investing and financing activities:

Capitalization of stock-based compensation	\$ 53	\$ 166
Acquisition of property and equipment included in accounts payable and accrued expenses	\$ 360	\$ 2,650
Issuance of common stock for acquisition	\$ —	\$ 5,733

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

Carbonite, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Nature of Business

Carbonite, Inc. ("we" or the "Company") was incorporated in the State of Delaware on February 10, 2005 and provides backup, disaster recovery, high availability and workload migration solutions (the "Carbonite Data Protection Platform"). The Carbonite Data Protection Platform supports global businesses with secure cloud infrastructure.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions between the Company and its subsidiaries have been eliminated in consolidation.

The accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC"), the instructions to Form 10-Q, and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto, included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the SEC on March 12, 2018.

In the opinion of management, the condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the Company's financial position for the periods presented. The results for the periods presented are not necessarily indicative of future results.

Reclassifications

The Company adopted Accounting Standard Update ("ASU") 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* ("ASU 2016-18"), effective January 1, 2018. Restricted cash is defined as cash and cash equivalents subject to contractual restrictions and not readily available for use. The Company applied this standard retrospectively by reclassifying restricted cash to be presented with cash and cash equivalents on the condensed consolidated statement of cash flows. As of December 31, 2016, the restricted cash balance of \$0.1 million related to a security deposit maintained for certain office space that was subleased to third parties. As of September 30, 2018 and December 31, 2017, the Company did not have a restricted cash balance reported within the condensed consolidated balance sheets.

The Company has reclassified certain prior period amounts in its condensed consolidated statements of operations to conform to the current period presentation. The reclassification relates to separately presenting amortization of intangible assets previously included within general and administrative and sales and marketing. For the three months ended September 30, 2017, the Company reclassified \$0.1 million from general and administrative and \$0.4 million from sales and marketing into the amortization of intangible assets caption within operating expenses. For the nine months ended September 30, 2017, the Company reclassified \$0.3 million from general and administrative and \$1.2 million from sales and marketing into the amortization of intangible assets caption within operating expenses.

The Company has reclassified certain prior period amounts in its condensed consolidated balance sheets to conform to the current period presentation. The reclassification relates to separately presenting accrued compensation which was previously included in the accrued expenses and other current liabilities caption. As of December 31, 2017, the Company reclassified \$9.9 million from accrued expenses and other current liabilities into the accrued compensation caption.

Recently Adopted Accounting Standards

The Company's significant accounting policies are presented in *Note 2 - Summary of Significant Accounting Policies*, in the Company's Annual Report on Form 10-K for fiscal year ended December 31, 2017 filed with the SEC on March 12, 2018. Summarized below are the accounting pronouncements adopted subsequent to December 31, 2017.

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("Topic 606"), which updated guidance and disclosure requirements for recognizing revenue. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The revenue standard is based on the principle that revenue should be recognized to depict the transfer of promised

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goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company adopted this standard effective January 1, 2018 using the modified retrospective transition method. The Company recognized the cumulative effect of applying the new standard as an adjustment to the opening balance of retained earnings at the beginning of 2018. The comparative information for 2017 has not been restated and continues to be reported under the accounting standards in effect for the period presented. Refer to *Note 3 - Revenue Recognition* for the required disclosures related to the impact of adopting this standard and a discussion of the Company's updated policies related to revenue recognition and accounting for costs to obtain and fulfill a customer contract.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory* ("ASU 2016-16"). The purpose of ASU 2016-16 is to simplify the income tax accounting of an intra-entity transfer of an asset other than inventory and to record its effect when the transfer occurs. The guidance is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods and early adoption is permitted. The Company adopted ASU 2016-16 effective January 1, 2018, which did not have a material impact on the consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Entities will also be required to reconcile such total to amounts on the balance sheet and disclose the nature of the restrictions. The guidance is effective for annual reporting periods beginning after December 15, 2017 and interim periods within those fiscal years. The Company adopted ASU 2016-18 effective January 1, 2018, which did not have a material impact on the consolidated financial statements. The Company applied this standard retrospectively by reclassifying restricted cash to be presented with cash and cash equivalents on the consolidated statement of cash flows.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*. The standard eliminates the second step in the goodwill impairment test which requires an entity to determine the implied fair value of the reporting unit's goodwill. The standard is effective for annual and interim goodwill impairment tests conducted in fiscal years beginning after December 15, 2019, with early adoption permitted. The Company elected to early adopt ASU 2017-04 effective January 1, 2018, which did not have a material impact on the consolidated financial statements.

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the assets and liabilities on their balance sheet for the rights and obligations created by most leases and continue to recognize expenses on their income statements over the lease term. It will also require disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. The guidance is effective for annual reporting periods beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the effect of the standard on its consolidated financial statements, and expects that upon adoption a significant lease obligation and right to use asset will be recognized. Refer to *Note 12 - Commitments and Contingencies* for additional information related to the Company's lease obligations.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. This standard aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard is effective for annual and interim periods beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

3. Revenue Recognition

On January 1, 2018, the Company adopted Topic 606 applying the modified retrospective method to all contracts that were not completed as of January 1, 2018. Where applicable, the Company utilized the practical expedient and reflected the aggregate effect of all contract modifications that occurred prior to adoption as they related to performance obligations (both satisfied and remaining) and determination and allocation of the transaction price. Under the modified retrospective method, results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the applicable accounting in effect for those periods.

The adoption of the Topic 606 did not significantly impact the majority of the Company's offerings. Under the new guidance, the Company's revenue recognition associated with term licenses and software contracts with a minimum monthly royalty commitment is accelerated. Further, the Company has begun capitalizing certain incremental costs incurred in obtaining

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contracts with customers as an asset on the condensed consolidated balance sheets. These costs were previously expensed in the period they were incurred. The Company recorded a \$13.9 million increase to retained earnings as of January 1, 2018, due to the cumulative impact of adopting Topic 606 on revenue from contracts with customers. Upon adoption, trade accounts receivable, net increased \$2.2 million and deferred revenue decreased \$4.0 million. Prepaid expenses and other current assets increased \$1.5 million and other assets increased by \$6.6 million primarily related to the capitalization of sales commissions. Deferred tax liabilities increased by \$0.4 million due to temporary differences between the accounting and tax carrying values of the capitalized commissions. The impact of adopting Topic 606 to revenues for the three month and nine month periods ended September 30, 2018 was a decrease of \$0.2 million and an increase of \$1.3 million, respectively.

Changes in Accounting Policies as a result of adopting Topic 606

The Company primarily sells products and services as discussed below. Each category contains one or more performance obligation that is either (i) capable of being distinct (i.e., the customer can benefit from the good or service on its own or together with readily available resources, including those purchased separately from the Company) and distinct within the context of the contract (i.e., separately identifiable from other promises in the contract), or (ii) a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. Aside from software licenses and hardware, which are delivered at a point in time, the majority of the Company's other services are delivered over time.

Under Topic 606, the Company recognizes revenue following a five step model, as outlined below:

- Identify the contract.
- Identify the performance obligations.
- Determine the transaction price.
- Allocate the transaction price.
- Recognize revenue.

Identifying the Contract

The Company considers itself to have a contract with a customer when all of the following are met:

- The parties have approved the contract;
- The Company can identify each party's rights regarding the goods or services to be transferred;
- The Company can identify the payment terms;
- The contract has commercial substance; and
- It is probable that the Company will collect substantially all of the consideration to which it will be entitled.

Performance Obligations and Timing of Revenue Recognition

Service Revenue

The Company offers "Software-as-a-Service" ("SaaS") and "Hardware-as-a-Service" ("HaaS") offerings. Most notably, the Company offers the customer the right to access its software through its SaaS offering, where the Company hosts the software and the customer is granted access via the web. Control of the software does not transfer in these types of arrangements and is therefore not considered a distinct performance obligation. Revenues related to the SaaS offerings are recorded over the performance period of the service. HaaS arrangements are accounted for under the guidance provided in ASC 840, *Leases*.

The Company also offers maintenance and support ("M&S") services for its licenses. M&S services generally consist of telephone, email, or live chat support, as well as updates and upgrades to the software licenses on an if and when available basis. All M&S obligations are considered distinct performance obligations that are of substantially the same duration and measure of progress and are therefore combined into a single performance obligation. As such, revenues from M&S are recorded ratably over the time of performance.

The Company also offers professional services to customers consisting of implementation, training, migration and protection services, and consulting. Professional services are regularly sold in conjunction with other products or services, as well as on a standalone basis and either (i) prepaid upfront or (ii) sold on a time and materials basis. Professional service revenue is recognized over time as services are delivered. For time and materials-based consulting arrangements, the Company has elected the practical expedient of recognizing revenue upon invoicing since the invoiced amount corresponds directly to the value of the Company's service to date.

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Product Revenue

The Company sells different types of on-premise data protection and migration software, licensed on a term or perpetual basis, and as royalty arrangements. License arrangements generally include maintenance and support services, but the software is fully functional upon delivery and is considered to be a distinct performance obligation. Revenues from product licenses are recorded when control of the product has been transferred to the customer.

The Company also offers hardware on a standalone basis or in conjunction with the Company's software. Hardware sales are recorded as revenue when control is transferred to the customer.

Determining the Transaction Price

To determine the transaction price, the Company considers both fixed and variable consideration. The majority of the Company's contracts contain fixed consideration that is paid up-front. Variable consideration is included in the transaction price to the extent it is probable that a significant reversal will not occur. The Company has the following sources of variable consideration:

Performance penalties - Subscription services and product support arrangements generally contain performance response time guarantees. For subscription services arrangements, the Company estimates variable consideration using a portfolio approach because performance penalties are tied to standard response time requirements. For product support arrangements, the Company estimates variable consideration on a contract basis because such arrangements are customer-specific. For both subscription services and product support arrangements, the Company uses an expected value approach to estimate variable consideration based on historical business practices and current and future performance expectations to determine the likelihood of incurring penalties.

Extended payment terms - The Company's standard payment terms are generally within 90 days of invoicing. If extended payment terms are granted to customers, those terms generally do not exceed one year. For contracts with extended payment terms, the Company estimates variable consideration on a contract basis because such estimates are customer-specific, and uses an expected value approach to analyze historical business experience on a customer-by-customer basis to determine the likelihood that extended payment terms lead to an implied price concession.

Sales and usage-based royalties - Certain product license arrangements include sales or usage-based royalties, covering both the software license and product support. Typically the arrangements consist of a minimum commitment as well as usage based "overage" fees. The Company includes the minimum commitments in determining the transaction price, however, excludes an estimate of sales or usage based "overages".

The Company has elected to exclude taxes assessed by government authorities in determining the transaction price, and therefore revenue is recognized net of taxes collected from customers.

Allocating the Transaction Price

The Company allocates the transaction price to each performance obligation based on the standard selling price ("SSP"), which is the price the Company regularly sells the product or service on a standalone basis. For certain products or services, a readily identifiable SSP is not available. In such cases, the Company estimates the SSP using the following methodologies:

Product licenses - Product licenses are not sold on a standalone basis. The Company establishes the SSP of product licenses using a residual approach after first establishing the SSP of the associated maintenance and support. Maintenance and support is sold on a standalone basis as annual renewals, and because an economic relationship exists between product licenses and maintenance and support, the Company has concluded that the residual method to estimate the SSP of product licenses sold on both a perpetual and term basis is an appropriate allocation of the transaction price.

Maintenance and Support (time-based licenses) - The Company establishes the SSP of maintenance and support included in time-based licenses based on similar percentages charged for maintenance and support of perpetual licenses because time-based licenses, when renewed, are renewed for the right to use the license as well as the ongoing maintenance and support. The Company believes this method is an appropriate allocation of maintenance and support in time-based license arrangements.

The Company infrequently provides options to purchase future products or services at a discount. The Company analyzes the option price against the SSP of the previously established goods or services to determine if the options represent material rights that should be accounted for as separate performance obligations. In general, options sold at or above the SSP are not considered separate performance obligations because the customer could have received that right without entering into the contract. If a material right exists, revenue associated with the option is recognized when the future goods or services are transferred, or when the option expires.

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Disaggregation of Revenue

The following table depicts disaggregated revenue for the three and nine months ended September 30, 2018, by type, customer type, sales channel, timing of revenue recognition, and geography (in thousands):

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Products	Services	Total	Products	Services	Total
Customer type						
Consumer	\$ —	\$ 24,917	\$ 24,917	\$ —	\$ 69,857	\$ 69,857
Business	7,392	45,373	52,765	25,764	123,821	149,585
Total	\$ 7,392	\$ 70,290	\$ 77,682	\$ 25,764	\$ 193,678	\$ 219,442
Sales channel						
Direct	\$ 811	\$ 48,841	\$ 49,652	\$ 2,891	\$ 132,717	\$ 135,608
Indirect	6,581	21,449	28,030	22,873	60,961	83,834
Total	\$ 7,392	\$ 70,290	\$ 77,682	\$ 25,764	\$ 193,678	\$ 219,442
Timing of revenue recognition						
Transferred at a point in time	\$ 7,392	\$ —	\$ 7,392	\$ 25,764	\$ —	\$ 25,764
Transferred over time	—	70,290	70,290	—	193,678	193,678
Total	\$ 7,392	\$ 70,290	\$ 77,682	\$ 25,764	\$ 193,678	\$ 219,442
Geography						
United States	\$ 3,431	\$ 62,663	\$ 66,094	\$ 11,725	\$ 172,673	\$ 184,398
Other	3,961	7,627	11,588	14,039	21,005	35,044
Total	\$ 7,392	\$ 70,290	\$ 77,682	\$ 25,764	\$ 193,678	\$ 219,442

Contract Assets and Liabilities

Contract assets are rights to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditional on something other than the passage of time. Contract assets are transferred to accounts receivable once the rights become unconditional. The Company did not have contract assets as of September 30, 2018.

Contract liabilities (deferred revenue) primarily consist of billings and payments received in advance of revenue recognition. The Company primarily bills and collects payments from customers for its services in advance on a monthly and annual basis. The Company initially records fees associated with performance obligations delivered over time as deferred revenue and then recognizes revenue as performance obligations are satisfied. The Company classifies deferred revenue as current or noncurrent based on the timing revenue recognition. Changes in contract liabilities for the nine months ended September 30, 2018 are as follows (in thousands):

	Deferred Revenue (Short-term)	Deferred Revenue (Long-term)
Balance as of January 1, 2018	\$ 96,243	\$ 24,273
Increase, net	25,027	3,771
Balance as of September 30, 2018	\$ 121,270	\$ 28,044

For the three and nine months ended September 30, 2018, revenue recognized related to deferred revenue at January 1, 2018 was approximately \$15.2 million and \$84.0 million, respectively. Additionally, for the three and nine months ended September 30, 2018, the Company recognized \$4.2 million and \$11.0 million of revenue from deferred revenue related to the acquisition of Mozy, Inc. ("Mozy") on March 19, 2018, respectively.

On September 30, 2018, the Company had \$161.5 million of remaining performance obligations. This amount does not include any variable consideration for sales or usage-based royalties. The Company expects to recognize 33.0% of its remaining performance obligations as revenue in the year ended December 31, 2018, an additional 53.0% for the year ended December 31, 2019 and the remaining balance thereafter.

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Accounts Receivable, Net

Accounts receivable, net, are amounts due from customers where there is an unconditional right to consideration. Unbilled receivables of \$3.6 million and \$4.2 million are included in this balance at January 1, 2018 and September 30, 2018, respectively. The payment of consideration related to these unbilled receivables is subjected only to the passage of time.

Contract Costs

The Company also considered Topic 606 subtopic 340-40, *Other Assets and Deferred Costs - Contracts with Customers* (“subtopic 340-40”). Prior to adoption of Topic 606, the Company expensed costs to obtain and fulfill contracts with customers as incurred. Under subtopic 340-40, the Company capitalizes incremental costs incurred in obtaining contracts with customers if the amortization period is greater than one year. For costs that the Company would have capitalized and amortized over one year or less, the Company has elected to apply the practical expedient and expense these contract costs as incurred. These costs consist primarily of commissions paid when contracts are signed. For the three and nine months ended September 30, 2018, the Company capitalized \$1.9 million and \$6.0 million in costs to obtain contracts with customers, respectively, which are amortized on a straight-line basis over the period of benefit. The Company has defined the period of benefit to be the average customer life of six years. For the three and nine months ended September 30, 2018, the Company had amortization expense of \$0.6 million and \$1.5 million related to deferred costs, respectively. Amortization expense is included in sales and marketing expense in the condensed consolidated statements of operations. As of September 30, 2018, the Company has \$2.5 million and \$10.0 million in current and non-current deferred costs of obtaining contracts with customers, respectively.

Financial Statement Impact of Adopting Topic 606

The Company adopted Topic 606 using the modified retrospective method. The cumulative effect of applying the new guidance to all contracts with customers that were not completed as of January 1, 2018 was recorded as an adjustment to accumulated deficit as of the adoption date. The following table summarizes the effects of adopting Topic 606 on the Company's condensed consolidated balance sheet as of September 30, 2018 (in thousands):

	September 30, 2018		
	As reported under Topic 606	Adjustments	Balances under Prior GAAP
Trade accounts receivable, net	\$ 32,582	\$ (2,941)	\$ 29,641
Prepaid expenses and other current assets	10,059	(2,499)	7,560
Other assets	13,072	(9,972)	3,100
Accrued expenses and other current liabilities	15,848	(222)	15,626
Current portion of deferred revenue	121,270	3,134	124,404
Deferred revenue, net of current portion	28,044	663	28,707
Other long-term liabilities	5,686	(349)	5,337
Accumulated other comprehensive income	1,529	139	1,668
Accumulated deficit	(148,621)	(18,777)	(167,398)

The following table summarizes the effects of adopting Topic 606 on the Company's condensed consolidated income statement for the three and nine months ended September 30, 2018 (in thousands, except per share amounts):

	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As reported under Topic 606	Adjustments	Balances under Prior GAAP	As reported under Topic 606	Adjustments	Balances under Prior GAAP
Revenue	\$ 77,682	\$ 194	\$ 77,876	\$ 219,442	\$ (1,257)	\$ 218,185
General and administrative	11,159	—	11,159	39,079	(595)	38,484
Sales and marketing	21,184	1,298	22,482	63,130	4,458	67,588
Provision (benefit) for income taxes	1,100	(106)	994	(13,777)	(222)	(13,999)
Net income (loss)	586	(998)	(412)	6,843	(4,898)	1,945
Net income (loss) per share - basic	0.02	(0.03)	(0.01)	0.23	(0.17)	0.06
Net income (loss) per share - diluted	0.02	(0.03)	(0.01)	0.21	(0.15)	0.06

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The adjustment to the general and administrative caption above relates to a sale of assets recorded in the nine months ended September 30, 2018. The deferred revenue divested as part of the sale was \$0.6 million higher under prior GAAP. This resulted in an adjustment between Topic 606 and prior GAAP related to the \$0.6 million change in deferred revenue and gain (loss) on the sale of the assets.

The adoption of ASC 606 did not affect the Company's reported total amounts of cash flows from operating, investing and financing activities in its condensed consolidated statement of cash flows.

Revision of Prior Period Amounts

The Company has revised certain prior period amounts in its condensed consolidated statements of operations. In connection with the Company's adoption of Topic 606, the Company determined that product revenue has historically exceeded 10% of total revenue and therefore should have been previously stated separately from services revenue. The Company has revised to correctly present the services and products components of revenue and cost of revenue in the condensed consolidated statements of operations for the three and nine months ended September 30, 2017. The revision also includes presenting as a separate caption within costs of revenue, the amortization of intangible assets, which was previously included in the total cost of revenue. These revisions did not affect reported total revenue, total cost of revenue, loss from operations, net income or net income per share, the Company's cash flows; or any balance sheet line item. The effect of the revisions to the condensed consolidated statements of operations for the three and nine months ended September 30, 2017, is as follows (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	As Previously Reported	Adjustments	As Revised	As Previously Reported	Adjustments	As Revised
Revenue:						
Services	\$ —	\$ 52,966	\$ 52,966	\$ —	\$ 154,131	\$ 154,131
Product	—	8,671	8,671	—	23,639	23,639
Total revenue	61,637	—	61,637	177,770	—	177,770
Cost of revenue:						
Services	—	14,627	14,627	—	45,176	45,176
Product	—	760	760	—	2,127	2,127
Amortization of intangible assets	—	2,203	2,203	—	5,953	5,953
Total cost of revenue	17,590	—	17,590	53,256	—	53,256

4. Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing the net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the sum of the weighted average number of common shares and potentially dilutive securities outstanding during the period using the treasury stock method. For the periods in which the Company incurred a net loss, the effect of the Company's outstanding common stock equivalents were not included in the calculation of diluted loss per share as they were anti-dilutive. Accordingly, basic and diluted net loss per share for those periods were identical.

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The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(in thousands, except share and per share amounts)				
Numerator:				
Net income (loss)	\$ 586	\$ (3,603)	\$ 6,843	\$ (2,388)
Denominator:				
Weighted average common shares outstanding, basic	32,876,529	27,795,858	29,965,390	27,714,273
Effect of potential dilutive common shares	3,577,914	—	2,796,912	—
Weighted average shares outstanding, diluted	36,454,443	27,795,858	32,762,302	27,714,273
Basic net income (loss) per share	\$ 0.02	\$ (0.13)	\$ 0.23	\$ (0.09)
Diluted net income (loss) per share	\$ 0.02	\$ (0.13)	\$ 0.21	\$ (0.09)

The Company has the ability and intent to settle the principal of the convertible senior notes (the "Convertible Notes"), issued in April 2017, in cash. As the Company's common stock price exceeded the \$25.84 conversion price during the three and nine months ended September 30, 2018, the Company has included the dilutive effect of shares in excess of the principal amount in the calculation of diluted net income per share as of September 30, 2018, using the treasury stock method.

The following options to purchase common shares, restricted stock units/awards and shares of common stock purchasable under the Company's 2017 Employee Stock Purchase Plan ("2017 ESPP") have been excluded from the computation of diluted net income per share because they had an anti-dilutive impact, or because they related to share-based awards that were contingently issuable, for which the applicable vesting conditions had not been satisfied:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Options to purchase common shares (1)	—	1,235,774	—	1,235,774
Restricted stock units/awards	—	1,860,681	61,960	1,860,681
Total	—	3,096,455	61,960	3,096,455

(1) These balances include shares purchasable under the Company's 2017 ESPP which were determined to be anti-dilutive.

5. Fair Value of Financial Instruments

Derivative Instruments

Non-designated Foreign Currency Contracts

The Company uses foreign currency forward contracts as part of its strategy to manage exposure related to Euro denominated intercompany monetary assets and liabilities. The Company has not designated these forward contracts as hedging instruments pursuant to ASC 815, *Derivatives and Hedging*. Accordingly, the Company recorded the fair value of these contracts at the end of each reporting period in the condensed consolidated balance sheets, with changes in the fair value recorded in earnings as other income (expense), net in the condensed consolidated statements of operations. Cash flows from the settlement of these non-designated foreign currency contracts are reported in cash flows from investing activities. These currency forward contracts are entered into for periods consistent with currency transaction exposures, generally less than one year. At September 30, 2018 and December 31, 2017, the Company had outstanding contracts with a total notional value of \$44.5 million and \$47.8 million, respectively.

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The following table provides a quantitative summary of the fair value of derivative instruments not designated as hedging instruments as of September 30, 2018 and December 31, 2017 (in thousands):

Description	Balance Sheet Classification	Fair Value	
		September 30, 2018	December 31, 2017
Derivative assets:			
<u>Non-Designated hedging instruments</u>			
Foreign currency contracts	Prepaid expenses and other current assets	\$ 369	\$ —
Total derivative assets		\$ 369	\$ —
Derivative liabilities:			
<u>Non-designated hedging instruments</u>			
Foreign currency contracts	Accrued expenses and other current liabilities	\$ —	\$ 439
Total derivative liabilities		\$ —	\$ 439

The following table summarizes the gains (losses) related to derivative instruments not designated as hedging instruments for the three and nine months ended September 30, 2018 and 2017 (in thousands):

Description	Location in Statement of Operations	Three Months Ended September 30,		Nine Months Ended September 30,	
		2018	2017	2018	2017
Foreign currency contracts	Other income (expense), net	\$ 492	\$ (1,430)	\$ 2,000	\$ (4,660)

Other Fair Value Measurements and Disclosures

The Company applies the guidance in ASC 820, *Fair Value Measurements and Disclosures*, (“ASC 820”), which provides that fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, ASC 820 establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar assets and liabilities or market corroborated inputs.

Level 3: Unobservable inputs are used when little or no market data is available, which requires the Company to develop its own assumptions about how market participants would value the assets or liabilities. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible in its assessment of fair value.

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The Company's assets and liabilities that are measured at fair value on a recurring basis, by level, within the fair value hierarchy are summarized as follows (in thousands):

	September 30, 2018				December 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents—money market funds	\$ 156,469	\$ —	\$ —	\$ 156,469	\$ 96,295	\$ —	\$ —	\$ 96,295
Foreign currency exchange contracts	—	369	—	369	—	—	—	—
Total	\$ 156,469	\$ 369	\$ —	\$ 156,838	\$ 96,295	\$ —	\$ —	\$ 96,295
Liabilities:								
Foreign currency exchange contracts	—	—	—	\$ —	—	439	—	\$ 439
Total	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 439	\$ —	\$ 439

The Company's investments in money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. The Company's foreign currency exchange contracts are classified as Level 2 within the fair value hierarchy as they are valued using professional pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets. No assets or liabilities are classified as Level 3 within the fair value hierarchy.

The Company estimates the fair value of its Convertible Notes using quoted market prices in an inactive market on the last trading day of the reporting period. The Convertible Notes have been classified as Level 2 within the fair value hierarchy. The principal amount, carrying value (the carrying value excludes the equity component of the Convertible Notes) and related estimated fair value of the Company's Convertible Notes reported in the condensed consolidated balance sheet as of September 30, 2018 are as follows (in thousands):

	September 30, 2018		
	Principal	Carrying Value	Fair Value
Convertible notes	\$ 143,750	\$ 116,640	\$ 213,069

The carrying amounts for cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses approximate fair value because of their short maturities.

Non-Recurring Fair Value Measures

Certain non-financial assets, such as goodwill, intangible assets and property and equipment, are measured at fair value on a non-recurring basis when there are identifiable events or changes in circumstances that may have a significant adverse impact on the fair value of these assets. Such fair value measures are considered to be within the Level 3 valuation hierarchy due to the subjective nature of the unobservable inputs used. During the nine months ended September 30, 2018, the Company recorded an impairment charge of \$0.7 million related to internally developed software costs which were no longer recoverable as the project was discontinued. The Company recorded the impairment charge in the cost of revenue, research and development, sales and marketing, and general and administrative captions in the condensed consolidated statements of operations. During the three and nine months ended September 30, 2017, the Company recorded an impairment charge of \$0.9 million related to a capitalized software project that was discontinued. The Company recorded the impairment charge in the research and development caption in the condensed consolidated statements of operations.

6. Acquisitions

Acquisition-Related Expenses

In the three months ended September 30, 2018 and 2017, acquisition-related expenses were \$0.2 million and \$0.2 million, respectively. In the nine months ended September 30, 2018 and 2017, acquisition-related expenses were \$5.7 million and \$3.9 million, respectively. Acquisition-related expenses have been included primarily in general and administrative expenses in the condensed consolidated statements of operations. The Company's current year acquisition costs relate to the acquisition of Mozy and the prior year acquisition costs relate to the acquisitions of Datacastle Corporation ("Datacastle") and DoubleTake Software, Inc. ("DoubleTake").

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2018 Acquisition

On February 12, 2018, the Company entered into a definitive Master Acquisition Agreement ("Agreement") with EMC Corporation ("EMC"), Mozy and Dell Technologies, Inc. Pursuant to the Agreement, on March 19, 2018, the Company completed the acquisition of all of the issued and outstanding capital stock of Mozy, a cloud backup service for consumers and businesses, and certain related business assets owned by EMC or its affiliates, for a purchase price of \$144.6 million in cash, net of cash acquired. The purchase price was funded with cash on hand and funds available under the Company's Revolving Credit Facility (refer to *Note 14*). In connection with the acquisition of Mozy, the Company negotiated a transition services agreement to cover certain consulting, technology and engineering services for up to eighteen months post close. The acquisition of Mozy has been accounted for as a business combination and the Company has recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date.

The purchase price allocation is considered preliminary, and additional adjustments may be recorded during the measurement period in accordance with FASB's guidance regarding business combinations. The purchase price allocation will be finalized as the Company receives additional information relevant to the acquisition related to the deferred tax assets and liabilities. The Company expects a release of the U.S. valuation allowance corresponding to any potential measurement period adjustments that impact the net U.S. deferred tax liability. During the second quarter of 2018, the Company recorded a measurement period adjustment in its condensed consolidated balance sheet associated with receiving additional information regarding the opening balance sheet as of March 19, 2018, the date of the acquisition. The measurement period adjustment was recorded as a \$1.2 million decrease to goodwill, with an offsetting decrease to deferred tax liabilities of \$1.4 million, an increase to deferred revenue of \$0.1 million and a decrease to intangible assets of \$0.1 million. The following table summarizes the preliminary purchase price allocation, which reflects the measurement period adjustments recorded in the second quarter of 2018 (in thousands):

Fair value of consideration transferred:	
Cash, net of cash acquired	\$ 144,597
Fair value of total acquisition consideration	<u>\$ 144,597</u>
Fair value of assets acquired and liabilities assumed:	
Accounts receivable	\$ 1,629
Prepaid and other current assets	872
Property and equipment	7,169
Other long-term assets	242
Intangible assets	96,400
Goodwill	74,753
Total assets acquired	<u>181,065</u>
Accounts payable	(141)
Accrued liabilities	(417)
Deferred revenues	(19,740)
Deferred tax liability	<u>(16,170)</u>
Net assets acquired	<u>\$ 144,597</u>

The Company engaged a third-party valuation firm to assist in the valuation of intangible assets consisting of customer relationships, developed technology and the Mozy trade name as well as in the valuation of deferred revenue and property and equipment. The fair values of the remaining Mozy assets and liabilities noted above approximate their carrying values at March 19, 2018.

In connection with the acquisition of Mozy, goodwill of \$74.8 million was recognized for the excess purchase price over the fair value of the net assets acquired. The Company believes the goodwill related to the acquisition was a result of the ability of the Company to leverage its technology in the broader market, as well as offering cross-selling market exposure opportunities. Goodwill from the acquisition of Mozy is included within the Company's one reporting unit and will be included in the annual review for impairment. Goodwill is not deductible for tax purposes as this acquisition was a stock purchase.

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The significant intangible assets identified in the purchase price allocation discussed above include customer relationships, developed technology, and trade names which are amortized over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis. Customer relationships represent the underlying relationships with certain customers to provide ongoing services for products sold. To value the customer relationship asset, the Company utilized the income approach, specifically a discounted cash-flow method known as the excess earnings method. Developed technology consists of products that have reached technological feasibility and trade names represent acquired company and product names. The developed technology intangible was valued using a relief from royalty method, which considers both the market approach and the income approach. The trade name intangible was valued using the replacement cost/lost profits methodology. The following table presents the estimated fair values and useful lives of the identifiable intangible assets acquired and risk-adjusted discount rates used in the valuation:

	Amount	Weighted Average Useful Life	Risk-Adjusted Discount Rates used in Valuation
	(in thousands)	(in years)	
Developed technology	\$ 8,700	2	12.5%
Customer relationships	87,200	7	16.5 - 17.5%
Trade names	500	2	12.5%
Total identifiable intangible assets	<u>\$ 96,400</u>		

For the three and nine months ended September 30, 2018, the operating results of Mozy, which are included in the Company's condensed consolidated statements of operations since the date of acquisition, include \$15.8 million and \$33.1 million of Mozy subscription revenue, respectively. Mozy subscription revenue does not include revenue associated with Mozy customers that have transitioned to Carbonite branded offerings. The Company has determined that disclosing the amount of Mozy related expenses included in the condensed consolidated statements of operations is impracticable, as certain operations of Mozy were integrated into the operations of the Company.

Pro Forma Financial Information

The following unaudited pro forma information presents the condensed consolidated results of operations of the Company and Mozy for the nine month periods ended September 30, 2018 and 2017 and the three month period ended September 30, 2017 as if the acquisition of Mozy had been completed on January 1, 2017. There was no pro forma impact during the three months ended September 30, 2018. These pro forma condensed consolidated financial results have been prepared for comparative purposes only and include certain adjustments that reflect pro forma results of operations, such as increased amortization for the fair value of acquired intangible assets, fair value adjustment for deferred revenue, additional annual interest expense resulting from interest on the Revolving Credit Facility to finance the acquisition of Mozy, reversal of depreciation expense resulting from the application of fair value measurement to acquired property and equipment and adjustments relating to the tax effect of combining the Carbonite and Mozy businesses.

The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the operations of the Company and Mozy. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of the results of operations that actually would have been achieved had the acquisition occurred as of January 1, 2017, nor are they intended to represent or be indicative of future results of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017		2018	2017
Pro forma revenue	\$ 78,501		\$ 234,450	\$ 227,722
Pro forma net (loss) income	\$ (2,569)		\$ 9,981	\$ (4,992)
Pro forma net (loss) income per common share:				
Basic	\$ (0.09)		\$ 0.33	\$ (0.18)
Diluted	\$ (0.09)		\$ 0.30	\$ (0.18)

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2017 Acquisitions

Datacastle

On August 14, 2017, the Company entered into an asset purchase agreement with Datacastle and completed the acquisition of all the assets associated with Datacastle's cloud data backup, caching and analytics software and services for data protection purposes, including Datacastle Red, Datacastle Analytics and Datacastle QuickCache products, for a purchase price of \$9.6 million in cash at closing. The acquisition of Datacastle has been accounted for as a business combination and, the Company has recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. Pro forma information has not been presented, as the operating results of Datacastle are not material. The following tables summarize the final purchase price allocation (in thousands):

Fair value of consideration transferred:	
Cash	\$ 9,600
Fair value of total acquisition consideration	<u>\$ 9,600</u>
Fair value of assets acquired and liabilities assumed:	
Accounts receivable	\$ 298
Prepaid expenses and other current assets	90
Intangible assets	3,440
Goodwill	6,267
Total assets acquired	<u>10,095</u>
Accrued liabilities	(175)
Deferred revenue	<u>(320)</u>
Net assets acquired	<u>\$ 9,600</u>

The Company engaged a third-party valuation firm to assist in the valuation of intangible assets and deferred revenue. The fair values of the remaining Datacastle assets and liabilities noted above approximate their carrying values at August 14, 2017. In connection with the acquisition of Datacastle, goodwill was recognized as the excess purchase price over the fair value of net asset acquired. The goodwill recorded in connection with this transaction is primarily related to the ability to leverage existing sales and marketing capacity and customer base with respect to the acquired product, as well as revenue and cash flow projections associated with future technologies. Goodwill from the acquisition of Datacastle is included within the Company's one reporting unit and will be included in the annual review for impairment. The goodwill is fully deductible for tax purposes.

The significant intangible assets identified in the purchase price allocation include developed technology and customer relationships, which are amortized over their respective useful lives on a straight line basis which approximates the underlying cash flows. To value the developed technology asset, the Company utilized the income approach, specifically a discounted cash-flow method known as the excess earnings method. The Company utilized the distributor earnings approach to derive the fair value of the customer relationships. The following table presents the fair values and useful lives of the identifiable intangible assets acquired and risk-adjusted discount rates used in the valuation:

	Amount	Weighted Average Useful Life	Risk-Adjusted Discount Rates used in Valuation
	(in thousands)	(in years)	
Developed technology	\$ 2,550	7	11.0%
Customer relationships	890	10	13.0%
Total identifiable intangible assets	<u>\$ 3,440</u>		

DoubleTake

On January 31, 2017, the Company completed the acquisition of all the outstanding capital stock of DoubleTake for a purchase price of \$65.9 million, which was comprised of \$59.7 million in cash paid at closing, net of cash acquired, 332,326 shares of the Company's common stock with a fair value of \$5.7 million and a working capital payment of \$0.5 million. The working capital payment was paid in June 2017. DoubleTake develops, sells, and supports affordable software that allows IT

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organizations of all sizes to move, manage, protect, and recover workloads across any distance and any combination of physical and virtual server environments. DoubleTake's products and services are marketed and sold worldwide through their direct sales force and a network of business partners and distributors. In connection with the acquisition of DoubleTake, the Company negotiated a transition services agreement to cover certain consulting, technology and accounting services for up to nine months post close, which ended in 2017. The acquisition of DoubleTake has been accounted for as a business combination and the Company has recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The following tables summarize the final purchase price allocation (in thousands):

Fair value of consideration transferred:		
Cash, net of cash acquired	\$	59,740
Fair value of equity instruments		5,733
Working capital payment		458
Fair value of total consideration	\$	<u>65,931</u>
Fair value of assets acquired and liabilities assumed:		
Accounts receivable	\$	6,058
Prepaid and other current assets		158
Property and equipment		428
Other long-term assets		42
Intangible assets		36,700
Goodwill		49,473
Total assets acquired		<u>92,859</u>
Accounts payable		(636)
Accrued liabilities		(2,156)
Deferred revenues		(9,100)
Deferred tax liability		(14,918)
Other non-current liabilities		(118)
Net assets acquired	\$	<u>65,931</u>

The Company engaged a third-party valuation firm to assist in the valuation of intangible assets consisting of developed technology, customer relationships, and the DoubleTake trade name as well as in the valuation of deferred revenue. The fair values of the remaining DoubleTake assets and liabilities noted above approximate their carrying values at January 31, 2017.

In connection with the acquisition of DoubleTake, goodwill of \$49.5 million was recognized for the excess purchase price over the fair value of the net assets acquired. The Company believes the goodwill recorded in connection with this transaction is primarily related to the investment value of the future enhancements of its product offering and solutions offering. Goodwill from the acquisition of Double-Take is included within the Company's one reporting unit and will be included in the annual review for impairment. Goodwill is not deductible for tax purposes as this acquisition was a stock purchase.

The significant intangible assets identified in the purchase price allocation discussed above include developed technology, trade names and customer relationships, which are amortized over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis. Developed technology consists of products that have reached technological feasibility and trade names represent acquired company and product names. To value the developed technology asset, the Company utilized the income approach, specifically a discounted cash-flow method known as the multi-period excess earnings method. The trade name intangible was valued using a relief from royalty method, which considers both the market approach and the income approach. Customer relationships represent the underlying relationships with certain customers to provide ongoing services for products sold. The Company utilized the replacement cost/lost profits methodology to derive the fair value of the customer relationships. The Company utilized accounting guidance related to intangible assets which lists the pertinent factors to be considered when estimating the useful life of an intangible asset. These factors include, in part, a review of the expected use by the Company of the assets acquired, the expected useful life of another asset (or group of assets) related to the acquired assets and legal, regulatory or other contractual provisions that may limit the useful life of an acquired asset.

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The following table presents the fair values and useful lives of the identifiable intangible assets acquired and risk-adjusted discount rates used in the valuation:

	Amount	Weighted Average Useful Life	Risk-Adjusted Discount Rates used in Valuation
	(in thousands)	(in years)	
Developed technology	\$ 29,900	5	13.5%
Customer relationships	4,900	6	12.0%
Trade names	1,900	8	12.0%
Total identifiable intangible assets	<u>\$ 36,700</u>		

The Company determined that disclosing the amount of DoubleTake related revenue and expenses included in the condensed consolidated statements of operations is impracticable as certain operations were integrated into the operations of the Company. Furthermore, the Company operates as one reportable segment and does not consider DoubleTake a separate reporting segment.

Pro Forma Financial Information (unaudited)

The following unaudited pro forma information presents the condensed consolidated results of operations of the Company and DoubleTake for the nine months ended September 30, 2017 as if the acquisition of DoubleTake had been completed on January 1, 2017. There was no pro forma impact for the three month period ended September 30, 2017. These pro forma condensed consolidated financial results have been prepared for comparative purposes only and include certain adjustments that reflect pro forma results of operations, such as increased amortization for the fair value of acquired intangible assets, fair value adjustment for deferred revenue, elimination of interest expense with a promissory note due to the parent company, and adjustments relating to the tax effect of combining the Carbonite and DoubleTake businesses.

The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings which may result from the consolidation of the operations of the Company and DoubleTake. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of the results of operations that actually would have been achieved had the acquisition occurred as of January 1, 2017, nor are they intended to represent or be indicative of future results of operations (in thousands, except per share data):

	Nine Months Ended September 30,
	2017
Pro forma revenue	\$ 181,051
Pro forma net loss	\$ (2,423)
Pro forma net loss per common share:	
Basic	\$ (0.09)
Diluted	\$ (0.09)

7. Goodwill and Acquired Intangible Assets

As of September 30, 2018 and December 31, 2017, the carrying amount of goodwill was \$155.3 million and \$81.0 million, respectively. The following is a rollforward of the Company's goodwill balance (in thousands):

	Goodwill
Balance as of December 31, 2017	\$ 80,958
Goodwill acquired	74,753
Goodwill divested	(29)
Effect of foreign exchange rates	(424)
Balance as of September 30, 2018	<u>\$ 155,258</u>

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Acquired intangible assets consist of the following (in thousands):

	Weighted-Average Estimated Useful Life (in years)	September 30, 2018			December 31, 2017		
		Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Technology-related	4.3	\$ 59,106	\$ 22,042	\$ 37,064	\$ 46,833	\$ 12,504	\$ 34,329
Customer relationships	6.8	97,025	9,933	87,092	11,295	3,361	7,934
Trade names	2.8	3,760	1,415	2,345	3,677	946	2,731
Non-compete agreements	0.0	—	—	—	230	230	—
Total	4.7	\$ 159,891	\$ 33,390	\$ 126,501	\$ 62,035	\$ 17,041	\$ 44,994

The Company recorded amortization expense of \$8.2 million and \$2.8 million for the three months ended September 30, 2018 and 2017, respectively; and \$19.6 million and \$7.5 million for the nine months ended September 30, 2018 and 2017, respectively. Amortization relating to developed technology is recorded within a separate line within cost of revenue and amortization of customer relationships, trade names and non-compete agreements are recorded within a separate line within operating expenses. Future estimated amortization expense of acquired intangibles as of September 30, 2018 is as follows (in thousands):

Remainder of 2018	\$ 8,491
2019	27,274
2020	22,422
2021	21,259
2022	15,356
Thereafter	31,699
	\$ 126,501

On October 3, 2017, the Company entered into a license and distribution agreement for technology to be utilized in future product offerings. As consideration for granting the license, the Company agreed to pay \$7.0 million in three separate milestone payments. The Company paid \$1.25 million upon transfer of all licensed materials in October 2017. A second \$1.25 million progress payment was made in January 2018. The third milestone was achieved in June 2018 upon the completion and acceptance of certain deliverables. The payment of the third milestone of \$4.5 million was made in July 2018. Under ASC 985, *Software, Subtopic 20, Costs of Software to Be Sold, Leased, or Marketed*, these costs are capitalized as incurred and amortized over their estimated useful life on a straight-line basis. During the nine months ended September 30, 2018, the Company capitalized \$5.8 million of costs associated with purchased software. As the product was released in late September, the amortization of these development costs will begin in October 2018 on a straight-line basis over the estimated useful life of the software, which was determined to be seven years.

8. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Accrued tax liabilities	\$ 3,934	\$ 2,280
Accrued consulting and professional fees	3,490	2,162
Accrued interest	1,862	898
Accrued sales and marketing	1,509	1,124
Accrued facilities	1,435	1,002
Accrued restructuring	333	688
Accrued other expenses	3,285	3,629
Total accrued expenses	\$ 15,848	\$ 11,783

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Additionally, the Company accrued \$9.4 million and \$9.9 million related to accrued compensation as of September 30, 2018 and December 31, 2017, respectively.

9. Stockholders' Equity

Share Repurchase Program

On May 11, 2015, the Company's Board of Directors authorized a \$20.0 million and subsequently increased to \$30.0 million share repurchase program, effective from May 15, 2015 through May 15, 2018. On May 15, 2018, the share repurchase program expired and was not renewed by the Company.

The Company did not make any repurchases under the program during the nine months ended September 30, 2018 or the three months ended September 30, 2017. The Company made the following repurchases during the nine months ended September 30, 2017:

	Nine Months Ended September 30,	
	2017	
	(total cost, in thousands)	
Number of shares repurchased		767,400
Average repurchase price per share	\$	19.50
Total cost	\$	14,964

Secondary Offering

On July 23, 2018, 4,765,157 shares of common stock, with a par value \$0.01 per share, were issued and sold in a public offering by the Company. Additionally, the underwriters exercised their full 30-day option on August 16, 2018 and an additional 819,485 shares were issued and sold. Proceeds of \$199.3 million were recognized by the Company, net of underwriting discounts and commissions and offering expenses paid. The net proceeds recognized less the par value of the shares issued were recorded within additional paid-in capital in the Company's condensed consolidated balance sheets.

10. Stock-based Awards

Employee Stock Purchase Plan

On May 18, 2017, the Company's stockholders approved the 2017 ESPP. Under the 2017 ESPP, eligible employees may purchase shares of the Company's common stock, subject to certain limitations, at the lesser of 85% of the beginning or ending withholding period fair market value as defined in the 2017 ESPP. There are two six-month withholding periods in each fiscal year. As of September 30, 2018, rights to acquire 484,185 shares of common stock were available for issuance under the 2017 ESPP.

Stock-based Compensation Expense

Stock-based compensation is reflected in the consolidated statement of operations as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of revenues	\$ 416	\$ 287	\$ 1,154	\$ 787
Research and development	1,022	590	2,756	1,304
General and administrative	2,656	1,860	7,274	5,800
Sales and marketing	889	517	2,277	1,329
Total stock-based compensation expense	<u>\$ 4,983</u>	<u>\$ 3,254</u>	<u>\$ 13,461</u>	<u>\$ 9,220</u>

11. Income Taxes

The Company's effective income tax rates were 65.2% and (7.0)% for the three months ended September 30, 2018 and 2017, respectively. The Company's effective income tax rates were 198.7% and 85.2% for the nine months ended September 30, 2018 and 2017, respectively. The Company's effective income tax rate is based upon estimated income before

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provision for income taxes for the year, composition of the income in different countries, and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits and/or resolutions of tax audits or other tax contingencies. For the nine months ended September 30, 2018, the effective income tax rate varied from the statutory income tax rate principally due to the release of U.S. valuation allowance as a result of the acquisition of Mozy and pre-tax book losses in the U.S. and Switzerland that cannot be benefited. The tax benefit recognized during the nine months ended September 30, 2018, consists of a tax benefit for a U.S. valuation allowance release that is partially offset by foreign tax expense. The tax provision recognized during the three months ended September 30, 2018, consists primarily of foreign tax expense.

The Company's effective income tax rate in the three months ended September 30, 2018 differed from the three months ended September 30, 2017, primarily due to an increase in worldwide pre-tax income in addition to an increase in foreign tax expense. The Company's effective income tax rate in the nine months ended September 30, 2018 differed from the nine months ended September 30, 2017, primarily due to the partial release of U.S. valuation allowance due to a net deferred tax liability recorded in the acquisition of Mozy. The U.S. net deferred tax liability primarily relates to non-tax deductible intangible assets recognized in the financial statements which generate a deferred tax liability. The net deferred tax liability established is estimated to be a source of income to utilize previously unrecognized deferred tax assets in the U.S. Therefore, the Company has recorded a discrete tax benefit of \$16.2 million and \$14.6 million in the nine months ended September 30, 2018 and 2017, respectively, for the release of valuation allowance related to the deferred tax liability recorded in purchase accounting. The U.S. maintains a valuation allowance on the overall U.S. net deferred tax asset as it is deemed more likely than not the U.S. net deferred tax asset will not be realized.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act ("Tax Act"), which significantly changes the pre-existing U.S. tax laws. The Tax Act includes a reduction in the U.S. corporate tax rate from 34% to 21%, a transition from a worldwide tax system to a modified territorial tax system, new taxes on certain foreign-sourced earnings, limitations on the deductibility of interest expense and executive compensation, as well as other changes.

In response to the Tax Act, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") which allows registrants to record provisional amounts during a measurement period, not to extend beyond one year. Pursuant to SAB 118, the Company will complete the accounting for the tax effects of all of the provisions of the Tax Act within the required measurement period not to extend beyond one year from the enactment date. As of September 30, 2018, the Company has concluded on the impact of the federal rate change, refundable Federal Alternative Minimum Tax ("AMT") credit, and the one-time tax on unrepatriated foreign earnings. There have been no changes in estimates or additional guidance issued during the nine months ended September 30, 2018 which would change the Company's assessment of the tax impacts recorded as of the year ended December 31, 2017. The Company is still analyzing both the Federal and state impacts of the Tax Act on certain foreign-sourced sales and earnings, limitations on the deductibility of interest expense and executive compensation, limitations on the deductibility of meals and entertainment, as well as other items changed in the Tax Act.

12. Commitments and Contingencies

Operating Leases

The Company leases facilities under leases that expire at varying dates through 2029. Certain of these leases contain renewal options and require the Company to pay operating costs, including property taxes, insurance, and maintenance.

The Company has lease agreements to rent office space in Boston, Massachusetts (corporate headquarters); Salt Lake City, Utah; and Indianapolis, Indiana as well as various other locations in North America and Europe. The Company has lease agreements to rent data center space in Ashburn, Virginia; Chandler, Arizona; and Phoenix, Arizona as well as various other locations in North America and Europe. Additionally, the Company has data center colocation agreements in place to rent colocation space. In August 2018, the Company entered into a new lease agreement for its Oakville, Canada office. The lease will commence on April 1, 2019 and expires on March 31, 2029. The terms of several of these leases include escalating rent and free rent periods. Accordingly, the Company recorded a deferred rent liability related to the free rent and escalating rent payments, such that rent is being recognized on a straight-line basis over the terms of the leases.

Rent expense was \$2.1 million and \$2.1 million for the three months ended September 30, 2018 and 2017, respectively, and \$6.6 million and \$6.6 million for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018 and December 31, 2017, \$4.2 million and \$4.7 million, respectively, was included in accrued expenses and other current liabilities and other long-term liabilities related to the deferred rent.

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Future non-cancellable minimum lease payments under all operating leases as of September 30, 2018, are as follows (in thousands):

Years Ended December 31,	Office Leases	Data Center Leases (1)	Total
Remainder of 2018	\$ 1,277	\$ 985	\$ 2,262
2019	4,578	2,488	7,066
2020	4,320	2,056	6,376
2021	4,220	2,056	6,276
2022	4,006	768	4,774
Thereafter	10,340	64	10,404
Total	\$ 28,741	\$ 8,417	\$ 37,158

(1) Certain amounts in the table above relating to colocation leases for the Company's servers include usage based charges in addition to base rent.

Other Non-cancellable Commitments

As of September 30, 2018, the Company had non-cancellable commitments to vendors primarily consisting of hosted software, consulting, advertising, marketing and broadband services contracts, as follows (in thousands):

Years Ended December 31,	
Remainder of 2018	\$ 4,615
2019	1,996
2020	638
2021	—
2022	—
Total	\$ 7,249

Litigation

On February 27, 2017, a non-practicing entity named Realtime Data LLC ("Realtime Data") filed a lawsuit against the Company in the U.S. District Court for the Eastern District of Texas, alleging that the Company's cloud storage services infringe upon certain patents held by Realtime Data. Realtime Data's complaint against the Company sought damages in an unspecified amount and injunctive relief. On December 19, 2017, the United States District Court for the Eastern District of Texas transferred the case to the United States District Court of Massachusetts. Realtime Data has filed several patent suits against several other companies around the country, and one or more of the asserted patents are currently in various stages of other litigations and/or United States Patent and Trademark Office ("USPTO") post-grant proceedings. The Company has requested the Court stay the case pending USPTO post-grant proceedings as to some of the asserted patents, and to bifurcate claim construction proceedings so as to have an early claim construction hearing on certain claim terms. No trial date has been set. The Company intends to defend itself vigorously. The Company has not accrued a loss contingency related to this matter because litigation related to a non-practicing entity is inherently unpredictable. Although a loss is reasonably possible, an unfavorable outcome is not considered by management to be probable at this time and the Company remains unable to reasonably estimate a possible loss or range of loss associated with this litigation.

The Company is from time to time subject to various other legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. The Company routinely assesses its current litigation and/or threatened litigation as to the probability of ultimately incurring a liability, and records its best estimate of the ultimate loss if reasonably possible to estimate, in situations where the Company assesses the likelihood of loss as probable. While the outcome of these other claims cannot be predicted with certainty, management does not believe that the outcome of any of these other legal matters will have a material adverse effect on the Company's condensed consolidated financial statements.

13. Restructuring

In October 2017, the Company initiated a restructuring program ("2017 Plan") to streamline operations and reduce operating costs. The Company has incurred restructuring charges totaling \$1.8 million related to employee severance under the

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2017 Plan and does not expect to incur any additional charges under the 2017 Plan. The remaining payments under the 2017 Plan are expected to be completed by the end of fiscal year 2018.

In the third quarter of 2018, the Company incurred restructuring expenses related to lease exit charges from a data center facility that was exited during the quarter, as the Company determined to consolidate select data center space. The remaining payments related to the exited facility will be paid through the end of fiscal year 2018. The following table summarizes the Company's restructuring activities for the nine months ended September 30, 2018 (in thousands):

	Employee Severance and Related Costs	Facilities Related Costs	Total
Accrued restructuring as of December 31, 2017	\$ 688	\$ —	\$ 688
Charges	793	467	1,260
Cash payments	(1,329)	(257)	(1,586)
Non-cash and other adjustments	(29)	—	(29)
Accrued restructuring as of September 30, 2018	\$ 123	\$ 210	\$ 333

The Company did not record any restructuring charges for the three or nine months ended September 30, 2017, nor did the Company did have any amounts accrued related to restructuring charges as of September 30, 2017.

14. Borrowings and Credit Arrangements

Revolving Credit Facility

On March 19, 2018, the Company entered into a Revolving Credit Facility with Silicon Valley Bank, Citizens Bank, N.A., HSBC Bank USA, N.A., Barclays Bank PLC and Wells Fargo Bank, National Association, which provides revolving credit financing of up to \$130.0 million, including a \$10.0 million sub-limit for letters of credit and a \$10.0 million sub-limit for swingline loans. The commitments under the Revolving Credit Facility may be increased by up to an additional \$100.0 million plus an additional unlimited amount so long as the Company does not exceed a specified pro forma secured net leverage ratio, in either case provided the existing or additional lenders are willing to make such increased commitments and subject to other terms and conditions.

The Revolving Credit Facility matures on the earlier of March 20, 2023 or, 91 days prior to the maturity of the Company's outstanding Convertible Notes, to the extent the same have not been repurchased, redeemed or otherwise refinanced as permitted under the Revolving Credit Facility. Borrowings bear interest at a variable rate equal to LIBOR plus an applicable margin as defined in the credit agreement. The Revolving Credit Facility is secured by substantially all of the Company's assets and contains customary affirmative and negative covenants, including, among others, certain limitations on the incurrence of indebtedness, guarantees and liens, the making of investments, acquisitions and dispositions, the payment of dividends and the repurchase of capital stock and the repayment, redemption or amendment of subordinated debt.

During the nine months ended September 30, 2018, the Company repaid \$90.0 million of its outstanding borrowings under the Revolving Credit Facility. As of September 30, 2018, the Company had no outstanding borrowings under the facility. The Revolving Credit Facility also contains certain financial covenant ratios related to leverage and interest coverage that the Company must maintain. As of September 30, 2018, the Company was in compliance with these covenants.

Convertible Notes

On April 4, 2017, the Company issued, in a private offering, \$143.8 million aggregate principal amount of Convertible Notes. The Convertible Notes accrue interest at 2.5% per year, payable semiannually in arrears on April 1 and October 1 of each year. The Convertible Notes will mature on April 1, 2022, unless earlier repurchased, redeemed or converted.

The conversion rate for the Convertible Notes is initially 38.7034 shares of Company's common stock per \$1,000 principal amount of Convertible Notes, which is equivalent to an initial conversion price of approximately \$25.84 per share of common stock. Prior to January 1, 2022, the Convertible Notes will be convertible by the holders only upon satisfaction of the following conditions and during following periods:

1. During any calendar quarter commencing after the calendar quarter ending on September 30, 2017 (and only during such calendar quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the

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immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

2. During the five business day period after any five consecutive trading day period (the "Measurement Period") in which the trading price per \$1,000 principal amount of notes for each trading day of the Measurement Period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day;
3. If the Company calls any or all of the notes for redemption at any time prior to the close of business on the second scheduled trading day immediately preceding the redemption date; and
4. Upon the occurrence of certain specified corporate events.

On or after January 1, 2022 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time. The Company may satisfy any conversion obligations by paying or delivering, as the case may be, cash, shares of its common stock or a combination of cash and shares of its common stock, at the Company's election in the manner and subject to the terms and conditions provided in the indenture governing the Convertible Notes.

The Company may redeem for cash all or any portion of the Convertible Notes, at its option, on or after April 5, 2020 if the last reported sale price of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), during any 30 consecutive trading day period ending on the trading day immediately preceding the date on which the Company provides notice of redemption at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date.

The Company received \$138.7 million in proceeds from the issuance of the Convertible Notes, net of debt issuance costs and the discounts to the initial purchasers. The Company used \$39.2 million of the proceeds to repay all amounts outstanding under its previous revolving credit facility and \$15.0 million of the proceeds to repurchase shares of its common stock from purchasers of Convertible Notes in privately negotiated transactions effected through one or more of the initial purchasers or their affiliates conducted concurrently with the pricing of the Convertible Notes. The remaining proceeds will be used for general corporate purposes, including potential acquisitions.

In accordance with ASC 470-20, *Debt with Conversion and Other Options*, the Company separated the Convertible Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Convertible Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the Convertible Notes. The equity component is included in the additional paid-in-capital portion of stockholders' equity on the Company's consolidated balance sheet, and is not remeasured as long as it continues to meet the conditions for equity classification.

In addition, the debt issuance costs and debt discount are allocated between the liability and equity components in proportion to the allocation of the proceeds. The issuance costs and discount allocated to the liability component are capitalized as a reduction of the principal amount of the Convertible Notes payable on the Company's balance sheet and amortized, using the effective-interest method, as additional interest expense over the term of the Convertible Notes. The issuance costs and discount allocated to the equity component are recorded as a reduction to additional paid-in capital. The Convertible Notes consisted of the following (in thousands):

	September 30, 2018	
Liability component:		
Principal	\$	143,750
Less: debt issuance costs		(611)
Less: debt discount		(26,499)
Net carrying amount	\$	116,640
Equity component (1)	\$	31,451

(1) As of September 30, 2018, a portion of the equity component was reclassified out of additional paid-in capital into temporary equity on the condensed consolidated balance sheet.

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The Convertible Notes were convertible during the third quarter 2018 and are convertible in the fourth quarter of 2018, as the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ended on June 30, 2018 and September 30, 2018 (immediately preceding calendar quarters) were greater than or equal to 130% of the conversion price on each applicable trading day. Accordingly, the net carrying amount of the Convertible Notes is classified as a current liability and a portion of the equity component representing the conversion option was classified as temporary equity in the Company's condensed consolidated balance sheets as of September 30, 2018. The portion of the equity component classified as temporary equity was \$27.1 million and is measured as the difference between the amount of cash deliverable upon conversion (i.e., principal value of the Convertible Notes) and net carrying amount of liability-classified component of the Convertible Notes.

For the three and nine months ending September 30, 2018 and 2017, the Company incurred total interest expense associated with the Convertible Notes as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest expense related to contractual interest coupon	\$ 898	\$ 898	\$ 2,695	\$ 1,757
Interest expense related to accretion of the discount	1,611	1,477	4,712	2,943
Interest expense related to debt issuance costs	37	34	109	68
Total	\$ 2,546	\$ 2,409	\$ 7,516	\$ 4,768

As of September 30, 2018, the net carrying value of the Convertible Notes was \$116.6 million, which is net of unamortized debt issuance costs of \$0.6 million. The effective interest rate on the Convertible Notes, including amortization of debt issuance costs and accretion of the discount, is 8.7%. Based on the Company's stock price on September 30, 2018, the if-converted value of the Convertible Notes exceeded the principal amount by \$54.6 million. As of September 30, 2018, no conversion options had been exercised.

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 in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed on March 12, 2018 with the SEC.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "will," "plan," "project," "seek," "should," "target," "will," "would," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, our ability to integrate acquisitions into our operations and achieve the expected benefits of such acquisitions, our ability to profitably attract new customers and retain existing customers, our dependence on the market for cloud backup services, our ability to manage growth, changes in economic or regulatory conditions or other trends affecting the Internet and the information technology industry, and those discussed in the section titled "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 12, 2018. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

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Overview

We are a leading provider of backup, disaster recovery, high availability and workload migration solutions (the "Carbonite Data Protection Platform"). The Carbonite Data Protection Platform supports global businesses with secure cloud infrastructure.

We derive the majority of our revenue from subscription fees with consistently strong retention rates. The remainder of our revenue is derived from software arrangements, which often contain multiple revenue elements, such as software licenses, hardware, professional services and post-contract customer support. We sell our solutions globally, and our customers primarily come from the following sources: directly from our website, our inside sales team, acquisitions, or from our network of channel partners, including distributors, value-added resellers, managed service providers, and global systems integrators.

We invest in customer acquisition because the market for our solutions is highly competitive. We support our sales network with a marketing approach that leverages our growing brand awareness to generate broad market demand. Our marketing efforts are designed to attract prospective customers and enroll them as paying customers, either through immediate sales, free trials or communication of the benefits of our solutions and development of ongoing relationships.

In 2017, we completed the acquisition of all the outstanding capital stock of DoubleTake for a purchase price of \$65.9 million, and the acquisition of the assets of Datacastle for a purchase price of \$9.6 million. On March 19, 2018, we acquired all of the issued and outstanding capital stock of Mozy for a purchase price of \$144.6 million in cash, net of cash acquired. We believe these acquisitions strengthen our overall leadership position in the data protection market and strengthen our technology portfolio.

On July 23, 2018, we issued and sold 4,765,157 shares of common stock in a public offering. An additional 819,485 shares were issued and sold pursuant to the underwriters' 30-day option on August 16, 2018. Proceeds of \$199.3 million were recognized, net of underwriting discounts, commissions and offering expenses paid.

Our operating costs continue to grow as we invest in strategic acquisitions, new customer acquisition, cross-sell efforts, and research and development. We expect to continue to devote substantial resources to integration, global expansion, customer acquisition, and product innovation. In October 2017, we initiated a restructuring program ("2017 Plan") to streamline operations and reduce operating costs. Since October 2017, we have recorded restructuring charges of \$1.8 million for employee severance related to the reduction of our workforce. We do not expect to incur any additional charges under the 2017 Plan and the remaining payments under the 2017 Plan are expected to be completed by the end of fiscal year 2018.

For the majority of our business, we defer revenue over our customers' subscription periods but expense marketing costs as incurred. Effective January 1, 2018, we adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("Topic 606") which impacts the recognition of costs incurred in obtaining contracts with customers. Under Topic 606, we amortize these costs, which primarily relate to commissions, over the period of benefit. While we have experienced periods of GAAP operating income, we may continue to incur GAAP operating losses in future periods.

Our Business Model

As the majority of our business is driven by subscription services, we evaluate the profitability of a customer relationship over the life of the customer relationship. We generally incur customer acquisition costs and capital equipment costs in advance of subscriptions while recognizing revenue ratably over the term of the subscriptions. As a result, a customer relationship may not be profitable or result in positive cash flow at the beginning of the subscription period, even though it may be profitable or result in positive cash flow over the life of the customer relationship. While we offer monthly, annual and multi-year subscription plans, a majority of our customers are currently on annual subscription plans. The annual or multi-year commitments of our customers enhance management's visibility into revenue, and charging customers at the beginning of the subscription period provides working capital.

Additional information about our business and operations is contained in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 12, 2018.

Key Business Metrics

Our management regularly reviews a number of financial and operating metrics, including the following key metrics, to evaluate our business. Bookings and adjusted free cash flow are financial data that are not calculated in accordance with GAAP. The presentation of non-GAAP financial information should not be considered in isolation or as a substitute for, or superior to,

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the financial information prepared and presented in accordance with GAAP. Refer to “Other Financial Data” for a reconciliation to the most comparable financial measures presented in accordance with GAAP.

- **Bookings.** We calculate bookings as revenue recognized during a particular period plus the change in total deferred revenue, excluding deferred revenue recorded in connection with acquisitions, divestitures and the adoption impact of Topic 606, net of foreign exchange and the change in unbilled revenue during the same period. Our management uses this measure as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions and software arrangements, which may include multiple revenue elements, such as software licenses, hardware, professional services and post-contractual support, received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the subscription period.
- **Annual retention rate.** We calculate annual retention rate as the percentage of subscription customers on the last day of the prior year who remain customers on the last day of the current year, or for quarterly presentations, the percentage of customers on the last day of the comparable quarter in the prior year who remain customers on the last day of the current quarter. Our management uses these measures to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships.
- **Renewal rate.** We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented. Our management uses this measure to monitor trends in customer renewal activity.
- **Adjusted free cash flow.** We calculate adjusted free cash flow by subtracting the cash paid for the purchase of property and equipment and adding the payments related to acquisitions, restructuring, and litigation from net cash provided by operating activities. Our management uses adjusted free cash flow to assess our business performance and evaluate the amount of cash generated by our business.

Subscription renewals may vary during the year based on the date of our customers’ original subscriptions. As we recognize subscription revenue ratably over the subscription period, this generally has not resulted in a material seasonal impact on our revenue but may result in material monthly and quarterly variances in one or more of the key business metrics described above.

Performance Highlights

For the three and nine months ended September 30, 2018 and 2017, we had the following results:

- Revenue for the three months ended September 30, 2018 was \$77.7 million, an increase of 26% from \$61.6 million for the three months ended September 30, 2017. Revenue for the nine months ended September 30, 2018 was \$219.4 million, an increase of 23% from \$177.8 million for the nine months ended September 30, 2017.
- Cash flow from operations for the three months ended September 30, 2018 was \$17.0 million, compared to \$6.9 million for the three months ended September 30, 2017. Cash flow from operations for the nine months ended September 30, 2018 was \$33.8 million, compared to \$17.3 million for the nine months ended September 30, 2017.

The following table presents our performance highlights for certain non-GAAP and other key metrics for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(in thousands, except percentage data)				
Key metrics (1):				
Bookings	\$ 78,795	\$ 59,665	\$ 228,169	\$ 185,687
Annual retention rate	86%	86%	86%	86%
Renewal rate	84%	86%	84%	85%
Adjusted free cash flow	\$ 17,251	\$ 6,015	\$ 32,967	\$ 10,367

(1) See the *Key Business Metrics* section above for the definition of these key metrics, and refer to the *Other Financial Data* section below for the reconciliation of bookings and adjusted free cash flow to the most directly comparable financial measures presented in accordance with GAAP.

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The following table presents our bookings by type of customer for the periods presented:

	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2018	2017		2018	2017	
(in thousands, except percentage data)						
Business	\$ 53,446	\$ 40,229	33%	\$ 153,770	\$ 123,303	25%
Consumer	25,349	19,436	30%	74,399	62,384	19%
Total bookings	\$ 78,795	\$ 59,665	32%	\$ 228,169	\$ 185,687	23%

Our bookings increased by \$19.1 million and \$42.5 million for the three and nine month periods ended September 30, 2018 compared to the corresponding periods ended September 30, 2017 primarily due to bookings from our recently acquired Mozy offerings. We expect total bookings to increase primarily driven by growth in business bookings.

Key Components of our Consolidated Statements of Operations

Revenue

Services. Services revenues consist of SaaS and HaaS offerings, M&S services and professional services. Revenues related to the SaaS offerings are recorded over the performance period of the service and HaaS arrangements are accounted for under the guidance provided in ASC 840, *Leases*. M&S services generally consist of telephone, email, or live chat support, as well as updates and upgrades to the software licenses on an if and when available basis. Revenues from M&S are recorded ratably over the time of performance. Professional service revenue is recognized over time as services are delivered.

Product. Product revenues consist of different types of on-premise data protection and migration software, licensed on a time or perpetual basis, and as royalty arrangements. Revenues from product licenses are recorded when control of the product has been transferred to the customer. We consider royalty and time-based sales to be subscription type arrangements. We also offer hardware on a standalone basis or in conjunction with our software. Hardware sales are recorded as revenue when control is transferred to the customer.

Cost of revenue

Services. Cost of services revenue consists primarily of costs associated with our data center operations and customer support centers, including wages and benefits for personnel, depreciation of equipment, rent, utilities and broadband, equipment maintenance, hosting fees, software license fees, and allocated overhead. The expenses related to hosting our services and supporting our customers are related to the number of customers and the complexity of our services and hosting infrastructure. Our cost of storage, on a per gigabyte (GB) basis has decreased over time due to decreases in storage prices and realizing greater efficiency in our data center operations. We have also experienced a downward trend in the cost of storage equipment and broadband service, which we expect will continue in the future. Over the long term, we expect these expenses to increase in absolute dollars, but decrease as a percentage of revenue due to improved efficiencies in supporting customers.

Products. Cost of product revenue consists primarily of hardware costs and royalty costs associated with licensing software from third-parties.

Amortization of intangible assets. Amortization of acquired technologies and licenses are included in cost of revenues. Intangibles are amortized over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis.

Gross profit and gross margin

Historically, our gross margins have expanded due to the introduction of higher priced solutions, a downward trend in the cost of storage equipment and services, and efficiencies of our customer support personnel in supporting our customers. We expect these trends to continue over the long term.

Operating expenses

Research and development. Research and development expenses consist primarily of wages and benefits for development personnel, third-party outsourcing costs, hosting fees, consulting fees, rent, and depreciation. We focus our research and development efforts on development of new products and enhancements and ease of use of our existing solutions. These efforts result in updated versions, while not changing the underlying technology. The majority of our research and development employees are located at our corporate headquarters in the U.S. and at our office in Canada. We expect that research and

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development expenses will increase in absolute dollars and as a percentage of revenue on an annual basis as we continue to enhance and expand our services.

General and administrative. General and administrative expenses consist primarily of wages and benefits for management, finance, accounting, human resources, legal and other administrative personnel, legal and accounting fees, insurance, acquisition and other corporate expenses. We expect that general and administrative expenses will increase in absolute dollars on an annual basis so that we can support the anticipated growth of our business.

Sales and marketing. Sales and marketing expenses consist primarily of wages and benefits for sales and marketing personnel, advertising costs, creative expenses for advertising programs, credit card fees, commissions paid to third-party partners and affiliates, and the cost of providing free trials. We expect that we will continue to commit significant resources to our sales and marketing efforts to grow our business and awareness of our brand and solutions.

Amortization of intangible assets. Amortization of acquired customer relationships, trade names, and non-compete agreements are included in operating expenses. Intangibles are amortized over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis.

Restructuring charges. Restructuring charges consist of charges related to the Company's restructuring efforts associated with the reorganization and consolidation of certain operations as well as disposal of certain assets. See *Note 13—Restructuring* to our consolidated financial statements included in this Quarterly Report for additional information.

Results of Operations

The following table sets forth, for the periods presented, data from our condensed consolidated statements of operations as a percentage of revenue that each line item represents. The period-to-period comparison of financial results is not necessarily indicative of future results. The information contained in the table below should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(% of total revenue)				
Consolidated statements of operations data:				
Revenue:				
Services	90.5 %	85.9 %	88.3 %	86.7 %
Product	9.5	14.1	11.7	13.3
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Services	22.0	23.7	23.2	25.4
Product	0.5	1.2	0.6	1.2
Amortization of intangible assets	5.6	3.6	5.0	3.4
Total cost of revenue	28.1	28.5	28.8	30.0
Gross profit	71.9	71.5	71.2	70.0
Operating expenses:				
Research and development	19.2	20.7	19.7	19.1
General and administrative	14.4	15.7	17.8	18.8
Sales and marketing	27.3	35.9	28.7	38.3
Amortization of intangible assets	5.0	0.9	3.9	0.9
Restructuring charges	0.4	0.0	0.6	0.0
Total operating expenses	66.3	73.2	70.7	77.1
Income (loss) from operations	5.6	(1.7)	0.5	(7.1)
Interest expense	(3.7)	(3.9)	(4.1)	(2.8)
Interest income	0.5	0.3	0.4	0.2
Other (expense) income, net	(0.2)	(0.1)	0.0	0.6
Income (loss) before income taxes	2.2	(5.4)	(3.2)	(9.1)
Provision (benefit) for income taxes	1.4	0.4	(6.3)	(7.8)
Net income (loss)	0.8 %	(5.8)%	3.1 %	(1.3)%

Comparison of the Three and Nine Months Ended September 30, 2018 and 2017

Revenue

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands, except percentage data)								
Revenue:								
Services	\$ 70,290	\$ 52,966	\$ 17,324	32.7 %	\$ 193,678	\$ 154,131	\$ 39,547	25.7%
As a % of total revenue	90.5%	85.9%			88.3%	86.7%		
Product	7,392	8,671	(1,279)	(14.8)%	25,764	23,639	2,125	9.0%
As a % of total revenue	9.5%	14.1%			11.7%	13.3%		
Total revenue	\$ 77,682	\$ 61,637	\$ 16,045	26.0 %	\$ 219,442	\$ 177,770	\$ 41,672	23.4%

Services revenue increased by \$17.3 million and \$39.5 million for the three and nine month periods ended September 30, 2018 compared to the corresponding periods in 2017, primarily due to an increase in revenue from our recently acquired Mozy offerings.

Product revenue decreased by \$1.3 million for the three month period ended September 30, 2018 compared to the corresponding period in 2017, primarily driven by the timing of revenue recognition of certain product offerings that were accelerated in the first half of 2018 under Topic 606. Product revenue increased by \$2.1 million for the nine month period

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ended September 30, 2018 compared to the corresponding period in 2017, primarily driven by the timing of revenue recognition of certain product offerings that were accelerated under Topic 606.

Cost of revenue, gross profit, and gross margin

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	2017	Change		2018	2017	Change	
	(in thousands, except percentage data)							
Cost of revenue:								
Services	\$ 17,094	\$ 14,627	\$ 2,467	16.9 %	\$ 50,782	\$ 45,176	\$ 5,606	12.4 %
Product	417	760	(343)	(45.1)%	1,348	2,127	(779)	(36.6)%
Amortization of intangible assets	4,317	2,203	2,114	96.0 %	11,067	5,953	5,114	85.9 %
Total cost of revenue	\$ 21,828	\$ 17,590	\$ 4,238	24.1 %	\$ 63,197	\$ 53,256	\$ 9,941	18.7 %
As a % of total revenue	28.1%	28.5%			28.8%	30.0%		
Gross profit	\$ 55,854	\$ 44,047			\$ 156,245	\$ 124,514		
Gross margin	71.9%	71.5%			71.2%	70.0%		

Our total gross margin increased to 71.9% from 71.5% for the three month period ended September 30, 2018, as compared to the three month period ended September 30, 2017, and increased to 71.2% from 70.0% for the nine month period ended September 30, 2018, as compared to the nine month period ended September 30, 2017, driven principally by an increase in service revenue, partially offset by an increase in cost of services and amortization of developed technology.

Cost of services revenue

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	2017	Change		2018	2017	Change	
	(in thousands, except percentage data)							
Cost of services revenue	\$ 17,094	\$ 14,627	\$ 2,467	16.9 %	\$ 50,782	\$ 45,176	\$ 5,606	12.4%
As a % of service revenue	24.3%	27.6%			26.2%	29.3%		
As a % of total revenue	22.0%	23.7%			23.2%	25.4%		
Components of cost of services revenue:								
Personnel-related costs	\$ 7,048	\$ 6,416	\$ 632	9.9 %	\$ 21,137	\$ 20,012	\$ 1,125	5.6%
Hosting, depreciation and facilities costs	7,147	5,009	2,138	42.7 %	20,193	15,852	4,341	27.4%
Software, consulting and other	2,899	3,202	(303)	(9.5)%	9,452	9,312	140	1.5%
Total cost of services revenue:	\$ 17,094	\$ 14,627	\$ 2,467	16.9 %	\$ 50,782	\$ 45,176	\$ 5,606	12.4%

Cost of service revenue increased for the three month period ended September 30, 2018, as compared to the three month period ended September 30, 2017, primarily related to an increase of \$0.9 million in depreciation and \$0.9 million in data center facilities costs included within hosting, depreciation and facilities costs associated with supporting our newly acquired Mozy customer base.

Cost of service revenue increased for the nine month period ended September 30, 2018, as compared to the nine month period ended September 30, 2017, related to an increase of \$1.1 million in personnel-related costs associated increased salaries and benefits and an increase of \$1.8 million in depreciation and \$2.0 million in hosted solutions costs included within hosting, depreciation and facilities costs.

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Cost of product revenue

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Cost of product revenue	\$ 417	\$ 760	\$ (343)	(45.1)%	\$ 1,348	\$ 2,127	\$ (779)	(36.6)%
As a % of product revenue	5.6%	8.8%			5.2%	9.0%		
As a % of total revenue	0.5%	1.2%			0.6%	1.2%		

Cost of product revenue decreased for the three and nine month periods ended September 30, 2018, as compared to the corresponding periods in 2017, primarily due to a decrease in hardware sales.

Amortization of intangible assets

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Amortization of intangible assets	\$ 4,317	\$ 2,203	\$ 2,114	96.0%	\$ 11,067	\$ 5,953	\$ 5,114	85.9%
As a % of total revenue	5.6%	3.6%			5.0%	3.4%		

Amortization of intangible assets increased by \$2.1 million and \$5.1 million for the three and nine month periods ended September 30, 2018, respectively, as compared to the corresponding periods in 2017, primarily due to an increase in developed technology amortization associated with the acquisition of Mozy that occurred in March 2018.

Operating expenses

Research and development

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Research and development	\$ 14,914	\$ 12,781	\$ 2,133	16.7%	\$ 43,152	\$ 34,035	\$ 9,117	26.8%
As a % of total revenue	19.2%	20.7%			19.7%	19.1%		
Components of research and development:								
Personnel-related costs	\$ 10,550	\$ 8,711	\$ 1,839	21.1%	\$ 31,250	\$ 25,219	\$ 6,031	23.9%
Outside services and consulting costs	2,541	1,052	1,489	141.5%	6,161	2,876	3,285	114.2%
Hosting and other	1,823	3,018	(1,195)	(39.6)%	5,741	5,940	(199)	(3.4)%
Total research and development:	\$ 14,914	\$ 12,781	\$ 2,133	16.7%	\$ 43,152	\$ 34,035	\$ 9,117	26.8%

Research and development expenses increased for each of the three and nine month periods ended September 30, 2018 as compared to the three and nine month periods ended September 30, 2017, primarily as a result of an increase in personnel-related costs associated with additional research and development headcount and an increase in outside services and consulting costs associated with enhancing the functionality and ease of use of our solutions. These increases were offset by a decrease in hosting and other costs primarily associated with a \$0.9 million impairment charge recorded in the third quarter of 2017 related to a discontinued capitalized software project.

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General and administrative

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands, except percentage data)								
General and administrative	\$ 11,159	\$ 9,676	\$ 1,483	15.3 %	\$ 39,079	\$ 33,399	\$ 5,680	17.0%
As a % of total revenue	14.4%	15.7%			17.8%	18.8%		
Components of general and administrative:								
Personnel-related costs	\$ 7,204	\$ 5,914	\$ 1,290	21.8 %	\$ 21,033	\$ 18,599	\$ 2,434	13.1%
Professional fees	1,547	1,957	(410)	(21.0)%	10,284	9,507	777	8.2%
Consulting, taxes and other	2,408	1,805	603	33.4 %	7,762	5,293	2,469	46.6%
Total general and administrative:	\$ 11,159	\$ 9,676	\$ 1,483	15.3 %	\$ 39,079	\$ 33,399	\$ 5,680	17.0%

General and administrative expenses increased by \$1.5 million for the three month period ended September 30, 2018, as compared to the three month period ended September 30, 2017, primarily related to a \$0.8 million increase in stock-based compensation expense associated with the achievement of performance goals and a \$0.5 million increase in employee salaries and benefits included within personnel-related costs.

General and administrative expenses increased by \$5.7 million for the nine month period ended September 30, 2018, as compared to the nine month period ended September 30, 2017 related to a \$1.5 million increase in stock-based compensation expense primarily associated with the achievement of performance goals and a \$0.9 million increase in salaries and benefits included within personnel-related costs. Further, there was a \$0.8 million increase in hardware and software costs driven by recent acquisitions, a \$0.7 million loss recorded on the sale of business and a \$0.6 million increase in transactional tax expense owed to foreign tax authorities included within consulting, taxes and other. The increase in these costs is driven by investment required to support our growth and operations as a public company.

Sales and marketing

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018	2017	Change		2018	2017	Change	
(in thousands, except percentage data)								
Sales and marketing	\$ 21,184	\$ 22,131	\$ (947)	(4.3)%	\$ 63,130	\$ 68,165	\$ (5,035)	(7.4)%
As a % of total revenue	27.3%	35.9%			28.7%	38.3%		
Components of sales and marketing:								
Personnel-related costs	\$ 9,671	\$ 10,365	\$ (694)	(6.7)%	\$ 29,146	\$ 32,156	\$ (3,010)	(9.4)%
Advertising costs	4,327	3,816	511	13.4 %	11,883	13,249	(1,366)	(10.3)%
Costs of credit card transactions and offering free trials	2,190	1,787	403	22.6 %	6,652	5,312	1,340	25.2 %
Marketing programs, consulting and other	4,996	6,163	(1,167)	(18.9)%	15,449	17,448	(1,999)	(11.5)%
Total sales and marketing:	\$ 21,184	\$ 22,131	\$ (947)	(4.3)%	\$ 63,130	\$ 68,165	\$ (5,035)	(7.4)%

Sales and marketing expenses decreased by \$0.9 million for the three month period ended September 30, 2018, as compared to the three month period ended September 30, 2017. The decrease was primarily due to a \$1.3 million decrease in personnel-related costs and marketing programs, consulting and other related to the adoption of Topic 606 as we now capitalize certain costs to obtain contracts with customers and amortize the costs over the period of benefit. Additionally, marketing programs, consulting and other costs decreased \$0.6 million primarily related to acquisition and integration-related costs and credit card processing fees increased \$0.4 million associated with the acquisition of Mozy.

Sales and marketing expenses decreased by \$5.0 million for the nine month period ended September 30, 2018, as compared to the nine month period ended September 30, 2017. The decrease was primarily due to a \$4.5 million decrease in personnel-related costs and marketing programs, consulting and other related to the adoption of Topic 606, as we now capitalize certain costs to obtain contracts with customers and amortize the costs over the period of benefit. Additionally,

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advertising costs decreased \$1.4 million primarily as a result of a reduction in consumer-focused marketing campaigns. These decreases were offset by increased credit card processing fees of \$1.3 million associated with the acquisition of Mozy.

Amortization of intangible assets

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Amortization of intangible assets	\$ 3,924	\$ 553	\$ 3,371	609.6%	\$ 8,515	\$ 1,535	\$ 6,980	454.7%
As a % of total revenue	5.0%	0.9%			3.9%	0.9%		

Amortization of intangible assets increased by \$3.4 million and \$7.0 million for the three and nine month periods ended September 30, 2018, as compared to the corresponding periods in 2017, primarily due to an increase in customer relationship amortization associated with the acquisition of Mozy that occurred in March 2018.

Restructuring

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Restructuring	\$ 357	\$ —	\$ 357	100.0%	\$ 1,260	\$ —	\$ 1,260	100.0%
As a % of total revenue	0.4%	—%			0.6%	0.0%		

Restructuring expenses for the three month period ended September 30, 2018 were \$0.4 million related to lease exit charges associated with exiting a data center facility early.

Restructuring expenses for the nine month period ended September 30, 2018 were \$1.3 million related to lease exit charges associated with a data center facility that was exited early and our October 2017 restructuring program, whereby we reduced our workforce in an effort to streamline operations and reduce operating costs. Refer to *Note 13 - Restructuring*, to our condensed consolidated financial statements included in this Quarterly Report for additional information.

Income (loss) from operations

Operating income (loss) for the three and nine month period ended September 30, 2018 increased compared to the corresponding periods ended September 30, 2017, primarily as a result of an increase in revenue and decrease in sales and marketing expenses, all partially offset by increases in costs of revenue, research and development expenses, general and administrative expenses and restructuring expenses.

Non-operating (expense) income

	Three Months Ended September 30,			Nine Months Ended September 30,				
	2018	2017	Change	2018	2017	Change		
	(in thousands, except percentage data)							
Interest expense	\$ (2,873)	\$ (2,416)	\$ (457)	18.9%	\$ (8,894)	\$ (5,011)	\$ (3,883)	77.5 %
As a % of total revenue	(3.7)%	(3.9)%			(4.1)%	(2.8)%		
Interest income	\$ 390	\$ 210	\$ 180	85.7%	\$ 803	\$ 364	\$ 439	120.6 %
As a % of total revenue	0.5 %	0.3 %			0.4 %	0.2 %		
Other (expense) income, net	\$ (147)	\$ (66)	\$ (81)	122.7%	\$ 48	\$ 1,129	\$ (1,081)	(95.7)%
As a % of total revenue	(0.2)%	(0.1)%			—%	0.6 %		

Interest expense increased for the three month period ended September 30, 2018, as compared to the corresponding period in 2017, primarily due to interest expense of \$0.3 million related to our Revolving Credit Facility entered into in March 2018.

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Interest expense increased for the nine month period ended September 30, 2018, as compared to the corresponding period in 2017, primarily due to an increase in interest expense of \$2.7 million related to our Convertible Notes issued in April 2017 and \$1.4 million of interest expense related to our Revolving Credit Facility entered into in March 2018.

Other (expense) income, net primarily represents net foreign exchange gains and losses and other non-operating expense and income items. Other (expense) income, net decreased for the three and nine month periods ended September 30, 2018 as compared to the corresponding periods in September 30, 2017, primarily due to exchange rate gains (losses) related to foreign currency exchange rate fluctuations on intercompany and other non-functional currency transactions.

Benefit for income taxes

We recorded income tax provisions of \$1.1 million and \$0.2 million for the three month periods ended September 30, 2018 and 2017, respectively. We recorded income tax (benefits) of \$(13.8) million and \$(13.8) million for the nine month periods ended September 30, 2018 and 2017, respectively. Our income tax provision for the nine month periods ended September 30, 2018 and 2017, is mainly composed of discrete tax benefits of \$16.2 million and \$14.6 million, respectively, related to the release of valuation allowance due to a net deferred tax liability recorded in the acquisitions of Mozy and DoubleTake, respectively, and is partially offset with foreign income tax expense. The U.S. net deferred tax liability recorded in the acquisitions of Mozy and DoubleTake primarily relates to non-tax deductible intangible assets recognized in the financial statements which generate a deferred tax liability. The net deferred tax liability established is estimated to be a source of income to utilize previously unrecognized deferred tax assets in the U.S. Therefore, the Company has recorded discrete tax benefits for the release of U.S. valuation allowance related to the deferred tax liability recorded in purchase accounting. The U.S. maintains a valuation allowance on the overall U.S. net deferred tax asset as it is deemed more likely than not the U.S. net deferred tax asset will not be realized.

Other Financial Data

In addition to our results discussed above determined under GAAP, we believe that bookings, annual retention rate, renewal rate, and adjusted free cash flow are useful to investors in evaluating our operating performance. See the *Performance Highlights* section above for the table presenting certain non-GAAP and other operational metric performance highlights for the three and nine months ended September 30, 2018 and 2017. Management considers these financial and operating metrics critical to understanding our business, reviewing our historical performance, measuring and identifying current and future trends, and for planning purposes. Securities analysts also frequently use bookings and adjusted free cash flow as supplemental measures to evaluate the overall performances of companies.

Bookings and adjusted free cash flow are financial data that are not calculated in accordance with GAAP. The tables below provide reconciliation of bookings and adjusted free cash flow to revenue and cash provided by operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP. The presentation of non-GAAP financial information should not be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP.

Our management uses annual retention rate to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships. As customers' annual and multi-year subscriptions come up for renewal throughout the calendar year based on the dates of their original subscriptions, measuring retention on a trailing twelve month basis at the end of each quarter provides our management with useful and timely information about the stability of our customer base. Management uses renewal rate to monitor trends in customer renewal activity.

Our management uses bookings as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions and software arrangements, which may include multiple revenue elements, such as software licenses, hardware, professional services and post-contractual support, received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the subscription period. Management uses bookings and adjusted free cash flow as measures of our operating performance; for planning purposes, including the preparation of our annual operating budget; to allocate resources to enhance the financial performance of our business; to evaluate the effectiveness of our business strategies; to provide consistency and comparability with past financial performance; to determine capital requirements; to facilitate a comparison of our results with those of other companies; and in communications with our Board of Directors concerning our financial performance. We also use bookings and adjusted free cash flow as factors when determining management's incentive compensation. Management believes that the use of bookings and adjusted free cash flow provides consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations, and also facilitates comparisons with other peer companies, many of which use similar non-GAAP financial measures to supplement their GAAP results.

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Although bookings and adjusted free cash flow are frequently used by investors and securities analysts in their evaluations of companies, these metrics have limitations as analytical tools, and you should not consider them in isolation or as substitutes for analysis of our results of operations as reported under GAAP. Some of these limitations are:

- bookings do not reflect our receipt of payment from customers;
- adjusted free cash flow does not reflect our future requirements for contractual commitments to vendors;
- adjusted free cash flow does not reflect the non-cash component of employee compensation or depreciation and amortization of property and equipment; and
- other companies in our industry may calculate bookings or adjusted free cash flow or similarly titled measures differently than we do, limiting their usefulness as comparative measures.

The following tables present reconciliations of our bookings and adjusted free cash flow to revenue and cash provided by operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Revenue	\$ 77,682	\$ 61,637	\$ 219,442	\$ 177,770
Add change in deferred revenue and unbilled revenue, net of foreign exchange (excluding acquisitions, divestitures, impact of adopting Topic 606)	1,113	(1,972)	8,727	7,917
Bookings	\$ 78,795	\$ 59,665	\$ 228,169	\$ 185,687

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(in thousands)			
Cash provided by operating activities	\$ 16,968	\$ 6,898	\$ 33,814	\$ 17,331
Subtract capital expenditures	(2,132)	(1,905)	(9,927)	(11,944)
Free cash flow	14,836	4,993	23,887	5,387
Add acquisition-related payments	1,891	954	7,219	4,843
Add restructuring-related payments	461	—	1,586	—
Add litigation-related payments	63	68	275	137
Adjusted free cash flow	\$ 17,251	\$ 6,015	\$ 32,967	\$ 10,367

Liquidity and Capital Resources

As of September 30, 2018, we had cash and cash equivalents of \$201.0 million, of which \$178.5 million was held in the United States and \$22.5 million was held by our international subsidiaries. If the undistributed earnings of our foreign subsidiaries are needed for our operations in the United States, we would be required to accrue and pay non-U.S. withholding taxes upon repatriation in certain non-U.S. jurisdictions. We currently do not expect to require repatriation of cash and investments to fund our U.S. operations and, as a result, we intend to indefinitely reinvest our foreign earnings to fund our foreign subsidiaries.

Sources of funds

We believe, based on our current operating plan, that our existing cash and cash equivalents and cash provided by operations, as well as access to a Revolving Credit Facility that we entered into in March 2018 and proceeds from our July 2018 public offering of common stock, will be sufficient to meet our anticipated cash needs for the foreseeable future.

On April 4, 2017, we issued, in a private offering, \$143.8 million aggregate principal amount of Convertible Notes. The Convertible Notes accrue interest at 2.50% per year, payable semiannually in arrears on April 1 and October 1 of each year. The Convertible Notes will mature on April 1, 2022, unless earlier repurchased, redeemed or converted. At September 30, 2018, the Convertible Notes are convertible at the option of the holders.

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In connection with the acquisition of Mozy, Inc., on March 19, 2018, we entered into a Revolving Credit Facility, which provides revolving credit financing of up to \$130.0 million, including a \$10.0 million sub-limit for letters of credit. The commitments under the Revolving Credit Facility may be increased by up to an additional \$100.0 million plus an additional unlimited amount so long as the Company does not exceed a specified pro forma secured net leverage ratio, in either case provided the existing or additional lenders are willing to make such increased commitments and subject to other terms and conditions. The Revolving Credit Facility matures on the earlier of March 20, 2023 or 91 days prior to the maturity of the Company's outstanding Convertible Notes. During the second quarter of 2018, we repaid \$10.0 million of our outstanding borrowings under the Revolving Credit Facility. On July 30, 2018, we repaid the remaining \$80.0 million of our outstanding borrowings under the Revolving Credit Facility with the net proceeds from the offering. As of September 30, 2018, we had no outstanding borrowings under the Revolving Credit Facility.

On July 23, 2018, 4,765,157 shares of common stock were issued and sold in a public offering by the Company. An additional 819,485 shares were issued and sold pursuant to the underwriters' 30-day option on August 16, 2018. Proceeds of \$199.3 million were recognized, net of underwriting discounts, commissions and offering expenses paid by the Company.

From time to time, we may explore additional financing sources to develop or enhance our solutions, fund expansion, respond to competitive pressures, acquire or to invest in complementary products, businesses or technologies, or to lower our cost of capital, which could include equity, equity-linked, and debt financing. There can be no assurance that any additional financing will be available to us on acceptable terms, if at all. If we raise additional funds through the issuance of equity or convertible debt or other equity-linked securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock.

Uses of funds

We have increased our operating and capital expenditures in connection with the growth in our operations and the increase in our personnel, and we anticipate that we will continue to increase such expenditures in the future. Our future capital requirements may vary materially from those now planned and will depend on many factors, including:

- potential future acquisition opportunities;
- the levels of advertising and promotion required to acquire and retain customers;
- expansion of our data center infrastructure necessary to support our growth;
- growth of our operations in the U.S. and worldwide;
- our development and introduction of new solutions; and
- the expansion of our sales, customer support, research and development, and marketing organizations.

Future capital expenditures will focus on acquiring additional data storage and hosting capacity and general corporate infrastructure. We are not currently party to any purchase contracts related to future capital expenditures, other than short-term purchase orders.

Cash flows

The following table summarizes our net cash inflows (outflows) for the nine months ended September 30, 2018 and 2017.

	Nine Months Ended September 30,	
	2018	2017
	(in thousands)	
Net cash provided by operating activities	\$ 33,814	\$ 17,331
Net cash used in investing activities	(158,424)	(84,970)
Net cash provided by financing activities	197,570	126,287

Operating activities

Our cash flows from operating activities are significantly influenced by the amount of our net income, growth in sales and customer growth, changes in working capital accounts, the timing of prepayments and payments to vendors, add-backs of non-cash expense items such as depreciation and amortization, and stock-based compensation expense.

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In the nine months ended September 30, 2018, cash provided by operating activities was \$33.8 million, which was driven by our net income of \$6.8 million, an increase in deferred revenue of \$9.8 million and a net adjustment for non-cash charges of \$33.7 million, primarily comprised of \$29.6 million of depreciation and amortization, \$13.5 million of stock-based compensation expense, \$4.7 million of non-cash interest expense related to the amortization of debt discount, \$0.7 million related to a capitalized software impairment, \$1.5 million in amortization of deferred costs, and other non-cash items of \$0.2 million, partially offset by a \$16.3 million benefit for deferred income taxes and a \$0.2 million gain on disposal of equipment. These cash inflows were partially offset by a \$11.8 million change in working capital and a \$4.7 million decrease in other assets and liabilities.

In the nine months ended September 30, 2017, cash provided by operating activities was \$17.3 million, which was driven by an increase in deferred revenue of \$7.6 million and a net adjustment for non-cash charges of \$12.8 million, primarily comprised of \$16.0 million of depreciation and amortization, \$9.2 million of stock-based compensation expense, \$3.0 million of interest expense related to the non-cash interest expense related to the amortization of debt discount, a \$0.9 million impairment of capitalized software, offset by a gain on disposal of equipment of \$0.9 million, a benefit for deferred income taxes of \$15.0 million and other non-cash items of \$0.4 million. These cash inflows were partially offset by our net loss of \$2.4 million, an increase in working capital of \$0.5 million and a decrease in other assets and liabilities of \$0.2 million.

Investing activities

In the nine months ended September 30, 2018, cash used in investing activities was \$158.4 million, which was primarily driven by our payment of \$144.6 million in connection with the acquisition of Mozy, capital expenditures of \$9.9 million, purchase of intangibles of \$5.8 million, and purchases of derivatives of \$1.4 million, partially offset by proceeds from the maturities of derivatives of \$2.6 million and proceeds from the sale of property and equipment and businesses of \$0.7 million.

In the nine months ended September 30, 2017, cash used in investing activities was \$85.0 million, which was primarily driven by our payment of \$69.8 million in connection with the acquisition of DoubleTake and Datacastle, capital expenditures of \$12.0 million, purchases of derivatives of \$4.8 million, partially offset by proceeds from the sale of property and equipment and businesses of \$1.2 million and proceeds from the maturities of derivatives of \$0.4 million.

Financing activities

In the nine months ended September 30, 2018, cash provided by financing activities was \$197.6 million, which was primarily driven by \$199.3 million in proceeds from the issuance of common stock from our secondary offering, \$88.1 million in proceeds from long-term borrowings, net of debt issuance costs, \$1.2 million in proceeds from issuance of treasury stock under the employee stock purchase plan, \$1.1 million in proceeds from the exercise of stock options, partially offset by \$90.0 million of payments on our Revolving Credit Facility and \$2.1 million in payments of withholding taxes in connection with restricted stock activity.

In the nine months ended September 30, 2017, cash provided by financing activities was \$126.3 million, which was primarily driven by \$177.8 million in proceeds from long-term borrowings, net of debt issuance costs and \$4.2 million in proceeds from the exercise of stock options, partially offset by \$39.2 million of payments on long-term borrowings, \$15.0 million in repurchases of common stock and \$1.5 million in payments of withholding taxes in connection with restricted stock activity.

Off-balance sheet arrangements

As of September 30, 2018, we did not have any off-balance sheet arrangements.

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Contractual obligations

The following table summarizes our contractual obligations at September 30, 2018 (in thousands):

	Payment Due by Period (1)				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
	(in thousands)				
Convertible Notes principal	\$ 143,750	\$ —	\$ —	\$ 143,750	\$ —
Convertible Notes interest	14,375	3,594	7,187	3,594	—
Office lease obligations	28,741	1,277	8,898	8,226	10,340
Data center lease obligations (2)	8,417	985	4,544	2,824	64
Hosted software solution obligations	2,905	737	2,168	—	—
Consulting obligations	1,187	1,187	—	—	—
Other purchase commitments	3,157	2,691	466	—	—
Total	<u>\$ 202,532</u>	<u>\$ 10,471</u>	<u>\$ 23,263</u>	<u>\$ 158,394</u>	<u>\$ 10,404</u>

(1) The future payments related to uncertain tax positions have not been presented in the table above due to the uncertainty of the amounts and timing of cash settlement with taxing authorities. There have been no material changes to our uncertain tax positions in the third quarter of 2018.

(2) Certain amounts in the table above relating to colocation leases for the Company's servers include usage based charges in addition to base rent.

The commitments under our office lease obligations shown above consist primarily of lease payments for our Boston, Massachusetts corporate headquarters, and our administrative offices in Salt Lake City, Utah and Indianapolis, Indiana.

Commitments under our data center lease obligations included above consist primarily of Ashburn, Virginia; Chandler, Arizona; and Phoenix, Arizona data centers. Additional commitments within this line consist of data center colocation agreements in place with Iron Mountain and DataBank.

Additionally, we have non-cancellable commitments to vendors primarily consisting of hosted software obligations, consulting obligations, and other purchase commitments, which consist of contractual commitments to various vendors primarily for advertising, marketing, and broadband services.

Critical Accounting Policies

Our financial statements are prepared in accordance with GAAP. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions, and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances, but all such estimates and assumptions are inherently uncertain and unpredictable. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition.

We consider the assumptions and estimates associated with revenue recognition, business combinations, goodwill and acquired intangible assets, income taxes and stock-based compensation to be our critical accounting policies and estimates. For further information on our critical and other significant accounting policies, see the notes to the condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K, as filed on March 12, 2018 with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For quantitative and qualitative disclosures about market risk affecting us, see Item 7A "Quantitative and Qualitative Disclosures about Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 12, 2018. Our exposure to market risks has not changed materially from that set forth in our Annual Report.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under 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, without limitation, 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. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2018, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 12 – Commitments and Contingencies to our condensed consolidated financial statements included in this Quarterly Report for information concerning litigation. In addition to the Realtime Data lawsuit, from time to time, we have been and may become involved in legal proceedings arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, we are not presently involved in any legal proceeding in which the outcome, if determined adversely to us, would be expected to have a material adverse effect on our business, operating results, or financial condition. 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

The Company's operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, liquidity and results of operations. There have been no material changes to the risks and uncertainties previously presented in "Item 1A. Risk Factors", in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 12, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Sale of Unregistered Securities

Not applicable.

(b) Use of Proceeds

Not applicable.

(c) Issuer Purchases of Equity Securities

During the three months ended September 30, 2018, 24,137 shares of our common stock were withheld to satisfy tax withholding obligations in connection with the vesting of restricted stock units. We did not repurchase any shares of our common stock, as our previously-announced share repurchase program expired without being renewed on May 15, 2018. The following table is a summary of the Company's withholding of our common stock upon the vesting of restricted stock units in the third quarter of 2018:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share (1)	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May be Purchased Under the Plans or Programs
July 1, 2018 - July 31, 2018	—	\$ —	—	\$ —
August 1, 2018 - August 31, 2018	6,627	\$ 36.60	—	\$ —
September 1, 2018 - September 30, 2018	17,510	\$ 41.56	—	\$ —
	<u>24,137</u>		<u>—</u>	

(1) The average price per share for each of the months in the fiscal quarter was calculated by dividing (a) the sum for the aggregate value of the tax withholding obligations by (b) the sum of the number of shares withheld.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

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ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

Not Applicable.

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ITEM 6. EXHIBITS

Exhibits

10.1#	R. Beeler Offer Letter.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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.

Indicates a management contract or compensatory plan.

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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.

CARBONITE, INC.

Dated: November 5, 2018

By: /s/ Anthony Folger

Anthony Folger
Chief Financial Officer

Dated: November 5, 2018

By: /s/ Cassandra Hudson

Cassandra Hudson
Chief Accounting Officer



October 17, 2018

OFFER LETTER

Robert Beeler

Dear Rob:

It is a pleasure to offer you a position on the Carbonite team! This Offer Letter serves to confirm the details of our employment offer as follows:

- Position:** **Senior Vice President, Products & Engineering**
- Status:** **Full-time, Regular, Exempt**
- Reporting to:** **Chief Executive Officer**
- Compensation:** Base salary of **\$11,538.46** bi-weekly, which is the equivalent of **\$300,000.00** annually, paid in accordance with the Company's normal payroll procedures.
- All forms of compensation which are referred to in this offer letter are subject to reduction to reflect applicable withholding, payroll and other required taxes and deductions. Please note that Carbonite may modify salaries and benefits from time to time as it deems necessary.
- Bonus:** You will be eligible for an incentive bonus of 45% of your base salary. The timing and amount of any bonus is subject to the discretion and approval of the Compensation Committee of the Board of Directors. See the Company's Bonus Plan for additional terms and conditions.
- Benefits:** **See Appendix A**
- Equity:** **\$400,000.00** in value of Restricted Stock Units of Carbonite's common stock, vesting over four years with 25% vesting on your first anniversary of your employment start date as Senior Vice President, Products & Engineering, and the balance vesting in equal annual installments thereafter. All equity grants described in this Section are subject to approval by Carbonite's Compensation Committee. Specific terms of the equity are governed by Carbonite's 2011 Equity Award Plan and separate equity award agreements.
- Severance:** You shall be eligible for an aggregate one-time payment of six months' pay, based on your base salary or base wages at the time of termination, in the event you are terminated other than for Cause, as defined in the 2011 Equity Award Plan. In the event a termination is the result of a Change of Control, as defined in the 2011 Equity Award Plan, you shall be eligible for an additional six months' pay based on your base salary or base wages at the time of termination and your total target bonus as if it had been achieved at 100%. Specific terms of the severance payments and any other applicable benefits are governed by Carbonite's Senior Executive Severance Plan.
-

At-Will Employment: Your employment with Carbonite is for no specified period of time and constitutes “at-will” employment. As a result, you are free to resign at any time, for any reason or for no reason, with or without notice. Similarly, Carbonite is free to conclude its employment relationship with you at any time, with or without cause, and with or without notice.

Other Agreements: All Carbonite employees are required, as a condition of your employment with Carbonite, to sign, on or before your first day of employment, the Company’s Confidentiality, Invention Assignment and Nonsolicitation Agreement. Please retain a signed copy for your files. We also ask that, if you have not already done so, you disclose to the Company any and all agreements relating to your prior employment that may affect your eligibility to be employed by the Company or that may limit the manner in which you may be employed.

You agree that, during the term of your employment with Carbonite, you will not engage in any other employment, occupation, consulting or other business activity directly related to the business in which Carbonite is now involved or becomes involved during the term of your employment, nor will you engage in any other activities that conflict with your obligations to Carbonite.

This Offer Letter, along with the Carbonite Confidentiality, Invention Assignment and Nonsolicitation Agreement, set forth the terms of your employment with Carbonite and supersede any prior representations or agreements, whether written or oral.

Expected Start Date: **On or Before October 21, 2018**

Expiration and Modification This Offer Letter may not be modified or amended except by a written agreement, signed by an authorized signatory of Carbonite and by you. **This offer will expire at 5pm, EST on October 17, 2018.**

Sincerely,

/s/ Alec Carstensen

Alec Carstensen
VP, HR and Talent Acquisition

ACCEPTANCE AND ACKNOWLEDGMENT

I accept the offer of employment from Carbonite as set forth in the Offer Letter dated October 17, 2018. I understand and acknowledge that my employment with Carbonite is at-will, for no particular term or duration and that I, or Carbonite, may terminate the employment relationship at any time, with or without cause and with or without prior notice. I acknowledge that the Company reserves the right to conduct background investigations and/or reference checks on all of its potential employees, and that my job offer, therefore, is contingent upon a clearance of such a background investigation and/or reference check, if any.

I understand and agree that the terms and conditions set forth in the Offer Letter represent the entire agreement between Carbonite and me superseding all prior negotiations and agreements, whether written or oral. I understand that the terms and conditions described in this Offer Letter, along with the Carbonite Confidentiality, Invention Assignment and Nonsolicitation Agreement are the terms and conditions of my employment. No one other than Carbonite’s Chief Executive Officer or Chief Financial Officer is authorized to sign any employment or other agreement which modifies the terms of the Offer Letter and Carbonite’s Carbonite Confidentiality, Invention Assignment and Nonsolicitation Agreement, and any such modification must be in writing and signed by either such executive.

Signature: /s/ Robert Beeler
Name: Robert Beeler
Date: October 17, 2018

CERTIFICATIONS

I, Mohamad Ali, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Carbonite, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 5, 2018

/s/ Mohamad Ali

Mohamad Ali

Chief Executive Officer

CERTIFICATIONS

I, Anthony Folger, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Carbonite, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 5, 2018

/s/ Anthony Folger

Anthony Folger
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Carbonite, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mohamad Ali, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Mohamad Ali

Mohamad Ali
President, and Chief Executive Officer

November 5, 2018

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Carbonite, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Anthony Folger, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Anthony Folger

Anthony Folger
Chief Financial Officer

November 5, 2018

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

