

Shutterstock, Inc.
Form 10-Q
November 07, 2014
Table of Contents

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, 2014

or

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

For the transition period from _____ to _____

Commission File Number: 001-35669

SHUTTERSTOCK, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

80-0812659
(I.R.S. Employer
Identification No.)

Jonathan Oringer

Chief Executive Officer

Shutterstock, Inc.

350 Fifth Avenue, 21st Floor

New York, NY 10118

(Address of principal executive offices, including zip code)

(646) 419-4452

(Registrant's telephone number, including area code)

Indicate by check mark whether 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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Edgar Filing: Shutterstock, Inc. - Form 10-Q

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

Class
Common Stock, \$0.01 par value per share

Outstanding at November 5, 2014
35,436,148

Table of Contents

Shutterstock, Inc.

Table of Contents

| | Page No. |
|--|-----------------|
| <u>PART I: FINANCIAL INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Financial Statements (Unaudited)</u> | 4 |
| <u>Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013</u> | 4 |
| <u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2014 and September 30, 2013</u> | 5 |
| <u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2014 and September 30, 2013</u> | 6 |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2014 and September 30, 2013</u> | 7 |
| <u>Notes to Consolidated Financial Statements</u> | 8 |
| <u>Item 2.</u> | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 21 |
| <u>Item 3.</u> | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 32 |
| <u>Item 4.</u> | |
| <u>Controls and Procedures</u> | 33 |
| <u>PART II: OTHER INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Legal Proceedings</u> | 34 |
| <u>Item 1A.</u> | |
| <u>Risk Factors</u> | 34 |
| <u>Item 2.</u> | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 34 |
| <u>Item 3.</u> | |
| <u>Defaults Upon Senior Securities</u> | 34 |
| <u>Item 4.</u> | |
| <u>Mine Safety Disclosures</u> | 34 |
| <u>Item 5.</u> | |
| <u>Other Information</u> | 34 |
| <u>Item 6.</u> | |
| <u>Exhibits</u> | 34 |
| <u>Signature</u> | 35 |
| <u>Exhibit Index</u> | 36 |
| Certifications | |

Table of Contents

SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology such as believe, may, estimate, continue, anticipate, intend, expect, predict, potential, project, guidance, target, forecast

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made and/or management's good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements as a result of certain factors, as more fully described in Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q and in the reports and documents filed from time to time by us with the Securities and Exchange Commission (the "SEC").

Forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

WHERE YOU CAN FIND MORE INFORMATION

Shutterstock's corporate website is located at www.shutterstock.com. Shutterstock makes available free of charge, on our corporate website, our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing to, the SEC. Information contained on Shutterstock's corporate website is not part of this report or any other report filed with the SEC.

Unless the context otherwise indicates, references in this report to the terms Shutterstock, the Company, we, our and us refer to Shutterstock, Inc. and its subsidiaries.

Table of Contents**PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****Shutterstock, Inc.****Consolidated Balance Sheets****(In thousands, except par value amount)****(unaudited)**

| | September 30, 2014 | December 31, 2013 |
|--|-------------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 210,760 | \$ 155,355 |
| Short-term investments | 49,720 | 54,429 |
| Credit card receivables | 3,758 | 2,083 |
| Accounts receivable, net | 12,938 | 6,081 |
| Prepaid expenses and other current assets | 14,462 | 19,809 |
| Deferred tax assets, net | 4,951 | 5,431 |
| Total current assets | 296,589 | 243,188 |
| Property and equipment, net | 26,422 | 20,256 |
| Intangible assets, net | 4,710 | 853 |
| Goodwill | 10,186 | 1,423 |
| Deferred tax assets, net | 16,193 | 10,720 |
| Other assets | 1,903 | 2,048 |
| Total assets | \$ 356,003 | \$ 278,488 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,686 | \$ 4,164 |
| Accrued expenses | 22,394 | 23,638 |
| Contributor royalties payable | 12,239 | 9,180 |
| Deferred revenue | 71,850 | 52,100 |
| Other liabilities | 1,901 | 2,846 |
| Total current liabilities | 114,070 | 91,928 |
| Other non-current liabilities | 11,700 | 3,961 |
| Total liabilities | 125,770 | 95,889 |
| Commitments and contingencies (Note 9) | | |
| Stockholders' equity: | | |
| Common stock, \$0.01 par value; 200,000 shares authorized; 35,430 and 35,071 shares outstanding as of September 30, 2014 and December 31, 2013, respectively | 354 | 351 |
| Additional paid-in capital | 160,099 | 127,443 |
| Accumulated comprehensive (loss) income | (72) | 9 |
| Retained earnings | 69,852 | 54,796 |
| Total stockholders' equity | 230,233 | 182,599 |

Edgar Filing: Shutterstock, Inc. - Form 10-Q

| | | | | |
|--|----|---------|----|---------|
| Total liabilities and stockholders' equity | \$ | 356,003 | \$ | 278,488 |
|--|----|---------|----|---------|

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

Shutterstock, Inc.

Consolidated Statements of Operations

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

(unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue | \$ 83,730 | \$ 59,558 | \$ 236,745 | \$ 167,484 |
| Operating expenses: | | | | |
| Cost of revenue | 33,260 | 22,936 | 94,419 | 64,525 |
| Sales and marketing | 21,122 | 14,947 | 60,890 | 40,240 |
| Product development | 9,870 | 5,685 | 26,922 | 15,300 |
| General and administrative | 10,588 | 6,076 | 28,095 | 16,590 |
| Total operating expenses | 74,840 | 49,644 | 210,326 | 136,655 |
| Income from operations | 8,890 | 9,914 | 26,419 | 30,829 |
| Other (expense) income, net | (50) | 20 | (48) | 29 |
| Income before income taxes | 8,840 | 9,934 | 26,371 | 30,858 |
| Provision for income taxes | 3,562 | 3,740 | 11,315 | 12,238 |
| Net income | \$ 5,278 | \$ 6,194 | \$ 15,056 | \$ 18,620 |
| Less: | | | | |
| Undistributed earnings to participating stockholder | 9 | 18 | 31 | 59 |
| Net income available to common stockholders | \$ 5,269 | \$ 6,176 | \$ 15,025 | \$ 18,561 |
| Net income per basic share available to common stockholders: | | | | |
| Undistributed | \$ 0.15 | \$ 0.18 | \$ 0.43 | \$ 0.55 |
| Basic | \$ 0.15 | \$ 0.18 | \$ 0.43 | \$ 0.55 |
| Net income per diluted share available to common stockholders: | | | | |
| Undistributed | \$ 0.15 | \$ 0.18 | \$ 0.42 | \$ 0.55 |
| Diluted | \$ 0.15 | \$ 0.18 | \$ 0.42 | \$ 0.55 |
| Weighted average shares outstanding: | | | | |
| Basic | 35,304,066 | 33,692,876 | 35,161,644 | 33,522,289 |
| Diluted | 35,931,454 | 34,280,656 | 35,883,202 | 34,043,573 |

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

Shutterstock, Inc.

Consolidated Statements of Comprehensive (Loss)/Income

(In thousands)

(unaudited)

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|-----------------------------------|---|-------|-------------|-------|--|--------|-------------|--------|
| | 2014 | | 2013 | | 2014 | | 2013 | |
| Net income | \$ | 5,278 | \$ | 6,194 | \$ | 15,056 | \$ | 18,620 |
| Foreign currency translation loss | | (121) | | | | (105) | | |
| Unrealized gain on investments | | 14 | | | | 24 | | |
| Other comprehensive loss | | (107) | | | | (81) | | |
| Comprehensive income | \$ | 5,171 | \$ | 6,194 | \$ | 14,975 | \$ | 18,620 |

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

Shutterstock, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 15,056 | \$ 18,620 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,757 | 2,738 |
| Write-off of property and equipment | 367 | |
| Deferred taxes | (4,181) | 15,086 |
| Non-cash equity-based compensation | 15,728 | 4,422 |
| Change in fair value of contingent consideration | 110 | |
| Excess tax benefit from the exercise of stock options | (10,224) | (3,226) |
| Bad debt reserve | 516 | 464 |
| Chargeback and sales refund reserves | 170 | 85 |
| Amortization of deferred financing fees | | 125 |
| Changes in operating assets and liabilities: | | |
| Credit card receivables | (1,704) | (1,153) |
| Accounts receivable | (7,374) | (4,176) |
| Prepaid expenses and other current and non-current assets | 15,574 | (20,508) |
| Accounts payable and other current and non-current liabilities | 7,978 | 5,971 |
| Contributor royalties payable | 3,059 | 2,018 |
| Deferred revenue | 18,667 | 11,995 |
| Net cash provided by operating activities | \$ 59,499 | \$ 32,461 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (16,334) | (4,788) |
| Purchase of investments | (214,506) | |
| Sale and maturities of investments | 219,239 | |
| Acquisition of business | (10,056) | |
| Acquisition of digital content | (331) | |
| Security deposit receipt/(payment) | 145 | (1,821) |
| Net cash used in investing activities | \$ (21,843) | \$ (6,609) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net proceeds from issuance of common stock in follow-on offering | | 65,895 |
| Proceeds from exercise of stock options | 6,673 | 4,003 |
| Proceeds from issuance of common stock under Employee Stock Purchase Plan | 945 | 1,065 |
| Excess tax benefit from the exercise of stock options | 10,224 | 3,226 |
| Payment of term loan | | (6,000) |
| Payment of offering fees | | (618) |
| Net cash provided by financing activities | \$ 17,842 | \$ 67,571 |
| Effect of foreign exchange rates changes on cash | (93) | |
| Net increase in cash and cash equivalents | 55,405 | 93,423 |
| Cash and cash equivalents Beginning | 155,355 | 102,096 |
| Cash and cash equivalents Ending | \$ 210,760 | \$ 195,519 |
| Supplemental Disclosure of Cash Information: | | |

Edgar Filing: Shutterstock, Inc. - Form 10-Q

Cash paid for:

| | | | | |
|--|----|-------|----|--------|
| Income taxes | \$ | 235 | \$ | 14,194 |
| Interest | \$ | | \$ | 34 |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | | | |
| Capital expenditures in accounts payable and other liabilities | \$ | 4,436 | \$ | 1,160 |

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

Shutterstock, Inc.

Notes to Unaudited Consolidated Financial Statements

(In thousands, except share and per share data)

(1) Summary of Operations and Significant Accounting Policies

Summary of Operations

Shutterstock, Inc. (the Company or Shutterstock) operates an industry-leading global marketplace for commercial digital imagery and music. Commercial digital imagery consists of licensed photographs, illustrations and videos that companies use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content while music consists of high-quality music tracks often used to complement the digital imagery. The Company licenses commercial digital imagery and music to its customers. Contributors upload their digital imagery and music tracks to the Company's website in exchange for a royalty payment based on customer download activity. The Company is headquartered in New York City with offices in Amsterdam, Berlin, Chicago, Denver, London, Paris, and San Francisco.

Principles of Consolidation

The consolidated financial statements reflect the operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Reorganization

In May 2012, in connection with the filing of a registration statement for the Company's initial public offering (the IPO), Shutterstock Images LLC, a New York limited liability company (the LLC) formed Shutterstock, Inc., a Delaware corporation, as a wholly-owned subsidiary of the LLC. On October 5, 2012, the LLC reorganized, by way of a merger of the LLC with and into Shutterstock, Inc. with Shutterstock, Inc. surviving in the merger (the Reorganization). In connection with the Reorganization, the preferred and common membership interests in the LLC, including any interests that vested upon the Reorganization, were exchanged for an aggregate of 28,338,281 shares of Shutterstock, Inc. common stock.

Follow-On Offering

On September 25, 2013, the Company completed a follow-on offering of 5,290,000 shares of its common stock, which included 690,000 shares of common stock sold by the Company and certain stockholders as a result of the underwriters' exercise of their option to purchase additional shares, at a price of \$60.00 per share. The Company sold 1,150,000 shares of common stock in the offering and the selling stockholders sold 4,140,000 shares of common stock in the offering. The aggregate offering price for shares sold by the Company in the offering resulted in net proceeds to the Company of \$65,895 after deducting underwriting discounts and commissions, and before deducting total expenses incurred in connection with the offering of approximately \$945.

Unaudited Interim Financial Statements

The interim consolidated balance sheet as of September 30, 2014, the consolidated statements of operations, comprehensive income and cash flows for the three and nine months ended September 30, 2014 and 2013 are unaudited. The unaudited interim financial statements have been prepared on a basis consistent with the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company's financial position as of September 30, 2014 and its results of consolidated operations, comprehensive income and cash flows for the three and nine months ended September 30, 2014 and 2013. The financial data and the other financial information disclosed in these notes to the financial statements related to these periods are also unaudited. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for the year ending December 31, 2014 or for any other future annual or interim period.

There have been no material changes in the significant accounting policies from those that were disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on February 28, 2014. These financial statements should also be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2013. Certain information and note disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2013 included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP.

Acquisition of Virtual Moment, LLC

On March 14, 2014, the Company acquired certain assets and certain liabilities of Virtual Moment, LLC (dba WebDAM) (WebDAM) pursuant to an asset purchase arrangement. The transaction was accounted for using the acquisition method, and accordingly, the results of the acquired business have been included in the Company's results of operations from the acquisition date.

WebDAM sells digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. WebDAM's products help organizations manage, search, distribute and collaborate on creative digital files in order to grow its brands and reach new audiences. WebDAM's offerings are particularly attractive to large enterprises, which make up a significant portion of their client base. The Company believes that this acquisition will strengthen its strategic position with its enterprise customers as well as broaden its product offerings to larger companies.

Table of Contents

The fair value of consideration transferred in this business combination was allocated to the intangible assets acquired and liabilities assumed at the acquisition date, with the remaining unallocated amount recorded as goodwill. The allocation of the purchase price for this acquisition has been prepared on a preliminary basis, and changes to those allocations may occur as additional information becomes available.

The total purchase price of \$12,416 consists of an initial cash payment of \$10,056 and \$2,360 in contingent consideration based on certain performance criteria of post-acquisition revenue. The fair value of the contingent consideration was determined using a Monte-Carlo simulation approach. The aggregate purchase price was allocated to the assets acquired and liabilities assumed as follows:

| | | |
|---------------------------|----|---------|
| Intangible assets: | | |
| Trade name | \$ | 500 |
| Customer relationships | | 2,800 |
| Developed technology | | 600 |
| Goodwill | | 8,763 |
| Total assets acquired | | 836 |
| Total liabilities assumed | | (1,083) |
| Total | \$ | 12,416 |

The identifiable intangible assets have a weighted average life of approximately seven years and are being amortized on a straight-line basis. The fair value of the customer relationships was determined using a variation of the income approach known as excess earnings method. The fair values of the trade name and developed technology were both determined using the relief-from-royalty method. The goodwill arising from the transaction is primarily attributable to expected operational synergies and is deductible for income tax purposes. As a result of the acquisition, the Company recorded approximately \$400 of professional fees for the nine months ended September 30, 2014 which is included in general and administrative expense. There were no professional fees as a result of the acquisition recorded during the three months ended September 30, 2014.

Pro forma results of operations have not been presented because the effect of this business combination was not material to the Company's consolidated results of operations.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires the Company's management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. The Company evaluates its significant estimates on an ongoing basis, including, but not limited to allowance for doubtful accounts, contingent consideration, sales refund reserve, goodwill, intangibles, non-cash equity-based compensation, income tax provision and for certain non-income tax accruals. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

Table of Contents

Restricted Cash

The Company's restricted cash relates to security deposits for leased office locations. As of September 30, 2014, the Company had \$188 of restricted cash recorded in prepaid expenses and other current assets that related to a leased office location that expires in the next twelve months and had \$1,829 of restricted cash recorded in other assets that related to a leased office location that expires in 2024. As of December 31, 2013, the Company had \$243 of restricted cash recorded in prepaid expenses and other current assets and had \$2,017 of restricted cash recorded in other assets. The carrying value of restricted cash approximates fair value.

Deferred Rent

The Company records rent expense on a straight-line basis over the term of the related lease. The difference between the rent expense recognized and the actual payments made in accordance with the lease agreement is recognized as a deferred rent liability on the Company's balance sheet. As of September 30, 2014, the Company has recorded a deferred rent balance of \$7,951, of which \$673 is included in other liabilities and \$7,278 is included in other non-current liabilities. As of December 31, 2013, the Company had recorded a deferred rent balance of \$4,783, of which \$2,406 is included in other liabilities and \$2,377 is included in other non-current liabilities.

Revenue Recognition

The vast majority of the Company's revenue, net of chargebacks and refunds, is generated from the license of digital content through subscription or usage based plans. The Company's three primary plans are: subscription plans, On Demand plans, and credit pack plans. The Company recognizes revenue when all of the following basic criteria are met: there is persuasive evidence of an arrangement, performance or delivery of services has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The Company considers persuasive evidence of an arrangement to be an electronic order form, or a signed contract, which contains the fixed pricing terms. Performance or delivery is considered to have occurred upon the ratable passage of time for subscription plans, the download of digital content or the expiration of a contract period for which there are unused downloads or credits. Collectability is reasonably assured since most of the Company's customers purchase products by making electronic payments at the time of a transaction with a credit card. The Company establishes a chargeback allowance and sales refund reserve allowance based on factors surrounding historical credit card chargeback trends, historical sales refund trends and other information. As of September 30, 2014 and December 31, 2013, the Company has recorded a combined chargeback allowance and sales refund allowance of \$595 and \$425, respectively, which is included in other liabilities. Collectability is assessed for customers who pay on credit based on a credit evaluation for new customers, when necessary, and transaction history with existing customers. Any cash received in advance of revenue recognition is recorded as deferred revenue.

Subscription plans range in length from thirty days to one year. Subscription plan revenues are recognized on a straight-line basis using a daily convention method over the plan term. On Demand plans are typically for a one-year term and permit the customer to download up to a fixed amount of digital content. On Demand revenues are recognized at the time the customer downloads the digital content on a per unit basis. Revenue related to unused digital content, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Credit pack plans are generally for a one-year term and enable the customer to purchase a fixed number of credits which can then be utilized to pay for downloaded digital content. The number of credits utilized for each download depends on the digital content size and format. Credit pack revenue is recognized based on customer usage on a per credit basis as digital content is downloaded. Revenue related to unused credits, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Most plans automatically renew at the end of the plan term unless the customer elects not to renew. The Company recognizes revenue from its three types of plans on a gross basis in accordance with the authoritative guidance on principal-agent considerations as the Company is the primary obligor in the arrangement, has control in establishing the product's price, performs a detailed review of the digital content before accepting it to its collection to ensure it is

of high quality before it may be purchased by the customers, can reject contributor's images in its sole discretion, and has credit risk.

Customers typically pay in advance (or upon commencement of the term) via credit card, wire or check. Fees paid or invoiced in advance are deferred and recognized as described above. Customers that do not pay in advance are invoiced and are required to make payment under standard credit terms. The Company does not generally offer refunds or the right of return to customers. There are situations in which a customer may receive a refund but the determination is made on a case-by-case basis.

The Company licenses digital content to customers through third party resellers. The Company contracts with third party resellers around the world to access markets where the Company does not have a significant presence. Third party resellers sell the Company's products directly to end-user customers and remit a fixed amount to the Company based on the type of plan sold. The terms of the reseller program indicate that the third party reseller is the primary obligor to the end-user customer and bears the risks and rewards as principal in the transaction. In assessing whether the Company's revenue should be reported on a gross or net basis with respect to our reseller program, the Company follows the authoritative guidance in ASC 605-45, *Principal Agent Considerations*. The Company recognizes revenue net of reseller commission in accordance with the type of plan sold, consistent with the plan descriptions above. The Company generally does not offer refunds or the right of return to resellers.

The Company also generates revenue related to WebDAM from licensing its hosted software services through its cloud-based platform and related implementation and professional services. The Company enters into multiple element revenue arrangements in which a customer purchases a combination of hosted software, implementation and optional value added professional services. The Company recognizes revenue for the hosted services monthly provided that there is persuasive evidence of an arrangement, the service has been delivered, the fees are fixed and determinable, and collection is reasonably assured. ASC 605-25 establishes a selling price hierarchy for determining the selling price of a deliverable in multiple-element arrangements, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) best estimated selling price. The hosted software services are recognized ratably over the contractual period as this service is on-going over the hosting period which is generally a one-year term. The Company defers revenue for the delivered elements until the undelivered element is delivered and then recognizes the delivered element revenue ratably over the longer of the contractual term or the estimated customer relationship period which is currently three years.

Equity-Based Compensation

The Company measures and recognizes non-cash equity-based compensation expense for all equity-based awards granted to employees based on estimated fair values. The value portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period. For awards with a change of control condition, an evaluation is made at the grant date and

Table of Contents

future periods as to the likelihood of the condition being met. Compensation expense is adjusted in future periods for subsequent changes in the expected outcome of the change of control conditions until the vesting date. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense related to awards with a market condition is recognized ratably over the requisite service period regardless of the achievement of the market condition.

The Company uses the Black Scholes option pricing model, the closing price of the Company's common stock on the date of grant, and the Monte Carlo simulation model, if the award has a market condition, to determine the fair value of stock options and restricted stock units (RSUs), respectively, granted pursuant to the Value Appreciation Rights Plan (VAR Plan), 2012 Omnibus Equity Incentive Plan (the 2012 Plan) and stock purchased pursuant to the Employee Stock Purchase Plan (2012 ESPP), which are discussed further in Note 11, Equity-Based Compensation.

The determination of the grant date fair value using an option-pricing model and simulation model requires judgment as well as assumptions regarding a number of other complex and subjective variables. These variables include the Company's fair value of the common ownership interest pre-IPO, the Company's closing market price at the grant date post-IPO, the expected unit price volatility over the expected term of the awards, awards' exercise and cancellation behaviors, risk-free interest rates, and expected dividends, which are estimated as follows:

- **Fair Value of Common Membership Unit.** Prior to completion of the IPO, the Company's fair value of common ownership interest was estimated internally and approved by the Board of Managers (BOM) because the Company was not publicly traded. The Company's intention upon granting VAR Plan awards was for the granted award to have exercisable price per unit that was not less than the per unit fair value of the Company's common equity on the date of grant. The valuations of the Company's common equity unit were prepared in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services 1: *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. The assumptions used in the valuation model were based on future expectations combined with the Company's judgment. In the absence of a public trading market, the Company exercised significant judgment and considered numerous objective and subjective factors to determine the fair value of the common equity unit as of the date of each VAR Plan award grant. Some but not all of these factors included operating and financial performance, current business conditions and projections, the hiring of key personnel, the Company's history and introduction of new functionality and services, the Company's stage of development, the likelihood of achieving a liquidity event for the common ownership interests, any adjustment necessary to recognize a lack of marketability for the common ownership interests, the market performance of comparable publicly traded companies, and U.S. and global capital market conditions. The Company also obtained independent third party valuations on a periodic basis. After October 11, 2012, the date the Company's common stock began trading on the NYSE, the grant date fair value for stock-based awards is based on the closing price of the Company's common stock on the NYSE on the date of grant and fair value for all other purposes related to stock-based awards shall be the closing price of the Company's common stock on the NYSE on the relevant date.

Table of Contents

- **Expected Term.** The expected term is estimated using the simplified method allowed under Securities and Exchange Commission (SEC) guidance.
- **Volatility.** As the Company does not have a trading history for its common ownership interest pre-IPO or a significant range of its common stock post-IPO, the expected price volatility for the common ownership interest and common stock was estimated by taking the average historic price volatility for industry peers based on daily price observations over a period equivalent to the expected term of the VAR Plan awards and stock options granted post-IPO. Industry peers consist of several public companies similar in size, stage of life cycle and financial leverage. The Company did not rely on implied volatilities of traded options in the industry peers' common stock because the volume of activity was relatively low. The Company intends to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of the Company's own common stock becomes available, or unless circumstances change such that the identified companies are no longer similar to the Company, in which case, more suitable companies whose share prices are publicly available would be utilized in the calculation.
- **Risk-free Interest Rate.** The risk-free interest rate is based on the yields of U.S. Treasury securities with maturities similar to the expected term of each award group.
- **Dividend Yield.** Prior to the Reorganization, the Company has historically paid cash dividends or distributions to its members. Following the Reorganization, the Company has not paid cash distributions to its stockholders and it does not intend to do so for the foreseeable future. As a result, the Company used an expected dividend yield of zero.

If any of the assumptions used in the Black-Scholes pricing model or Monte Carlo simulation model changes significantly, the fair value for future awards may differ materially compared with the awards granted previously. The awards granted pursuant to the VAR Plan, the 2012 Plan, and the 2012 ESPP are subject to a time-based vesting requirement and for certain award grants are also based on a market condition. The majority of stock option awards granted under the 2012 Plan vest over four years while the majority of the restricted stock units granted under the 2012 Plan vest over three years. The 2012 ESPP provides for purchase periods approximately every six months and a participant must be employed on the purchase date to participate. The VAR Plan awards had a condition that a change of control (as defined in the VAR Plan) must occur for a payment to trigger with respect to the VAR Plan awards. In connection with the Company's Reorganization, all of the VAR Plan awards were exchanged for options to purchase shares of common stock of Shutterstock, Inc. As of December 31, 2011, no equity-based compensation expense had been recognized with respect to the VAR Plan awards because the qualifying event had not occurred. As a result of the completion of the initial public offering (IPO) in October 2012, the Company began recording stock-based compensation expense using the accelerated attribution method, net of forfeitures, based on the grant date fair value of the VAR Plan awards that were exchanged for options to purchase shares of common stock of Shutterstock, Inc. as part of the Company's Reorganization.

For pre-IPO equity based awards that qualified for liability classification, the Company has elected to use the intrinsic value method to value the common membership interest in accordance with authoritative guidance on stock compensation. See Note 11, Equity-Based Compensation, for further information.

Income Taxes

Edgar Filing: Shutterstock, Inc. - Form 10-Q

The Company is a Delaware corporation and is therefore subject to federal and state income tax. Significant management judgment is required in projecting ordinary income/(loss) in order to determine the Company's estimated effective tax rate.

The Company accounts for unrecognized tax benefits using a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes may be due. The Company records an income tax liability, if any, for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on the Company's tax returns. To the extent that the assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. The reserves are adjusted in light of changing facts and circumstances, such as the outcome of a tax audit or lapses in statutes of limitations. Any reserve for uncertain tax provisions, if any, and related penalties and interest, if any, are included in the income tax provision.

The Company assessed the realizability of deferred tax assets and determined that based on the available evidence, including a history of taxable income and estimates of future taxable income, it is more likely than not that the deferred tax assets will be realized. The Company will continue to evaluate its ability to realize deferred tax assets on a quarterly basis. Significant management judgment is required in determining the provision for income taxes and deferred tax assets and liabilities. In the event that actual results differ from these estimates, the Company will adjust these estimates in future periods which may result in a change in the effective tax rate in a future period.

The Company is subject to compliance requirements for certain non income taxes, including value added taxes, sales taxes and royalty withholding taxes. Where appropriate, the Company has made accruals for these taxes, which are reflected in the Company's consolidated financial statements.

Table of Contents***Net Income Per Share***

Basic net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. The Company applies the two class method for calculating and presenting income per share. Under the two-class method, net income is allocated between shares of common stock and other participating securities based on their contractual participating rights to share in the earnings as if all of the earnings for the period have been distributed. Participating securities are defined as securities that participate in dividends with common stock according to a pre-determined formula or a contractual obligation to share in the income of the entity. Any potential issuance of common shares, including those that are contingent and do not participate in dividends, are excluded from weighted average number of common shares outstanding. Undistributed net income (loss) for a given period is apportioned to participating stockholders based on the weighted average number of shares for each class of securities outstanding during the applicable period as a percentage of the combined weighted average number of these securities outstanding during the period. Income available to common stockholders is computed by deducting dividends paid to preferred stockholders, accretion to redemption value on preferred members shares, less income allocated to participating securities including unvested shares for the restricted award holder since these unvested shares have participating rights. See Note 11, Equity-Based Compensation, for further discussion.

Diluted net income per share is computed by dividing the net income available to common stockholders adjusted for any changes in income that would result from the assumed conversion of the potential common shares by the weighted average common shares outstanding and all potential common shares, if they are dilutive. Diluted net income available to common stockholders for the three and nine months ended September 30, 2014 includes the effect of 2,136,637 and 2,161,146 shares, respectively, while 617,250 and 472,977 shares, respectively, were excluded since they were anti-dilutive. Diluted net income available to common stockholders for the three and nine months ended September 30, 2013 includes the effect of 1,589,748 and 1,717,767 shares, respectively, while 376,550 and 229,367 shares, respectively, were excluded since they were anti-dilutive.

A reconciliation of assumed exercised shares used in calculating basic and diluted net income per share available to common stockholders follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|------------|---------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Basic | 35,304,066 | 33,692,876 | 35,161,644 | 33,522,289 |
| Stock options and employee stock purchase plan shares | 552,282 | 536,741 | 627,845 | 444,556 |
| Unvested restricted stock awards | 75,106 | 51,039 | 93,713 | 76,728 |
| Diluted | 35,931,454 | 34,280,656 | 35,883,202 | 34,043,573 |

Recently Issued Accounting Standard Updates

In May 2014, the Financial Accounting Standards Board (FASB) issued new accounting guidance related to revenue recognition. This new standard will replace all current GAAP guidance on this topic and will eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact, if any, of adopting this new accounting standard on its financial statements.

In June 2014, the FASB issued new guidance related to stock compensation. The new standard requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and can be applied either prospectively or retrospectively to all awards outstanding as of the beginning of the earliest annual period presented as an adjustment to opening retained earnings. Early adoption is permitted. The Company is evaluating the impact, if any, of adopting this new accounting standard on its financial statements.

(2) Short Term Investments and Fair Value Measurements

Short term investments are summarized as follows:

| | As of September 30, 2014 | | | |
|------------------|--------------------------|---------------------|----------------------|-----------------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Market Value |
| Commercial paper | \$ 49,722 | \$ | \$ (2) | \$ 49,720 |
| Total | \$ 49,722 | \$ | \$ (2) | \$ 49,720 |

Table of Contents

| | As of December 31, 2013 | | | |
|------------------|-------------------------|---------------------|----------------------|-----------------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Market Value |
| Commercial paper | \$ 54,431 | \$ | \$ (2) | \$ 54,429 |
| Total | \$ 54,431 | \$ | \$ (2) | \$ 54,429 |

The following tables present the Company's fair value hierarchy for its assets and liabilities:

| | As of September 30, 2014 | | | |
|--|--------------------------|-----------|-----------|----------|
| | Aggregate Fair Value | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Money market accounts | \$ 86,342 | \$ 86,342 | \$ | \$ |
| Commercial paper | 49,720 | | 49,720 | |
| Total assets measured at fair value | \$ 136,062 | \$ 86,342 | \$ 49,720 | \$ |
| Liabilities: | | | | |
| Acquisition related contingent consideration | \$ 2,470 | \$ | \$ | \$ 2,470 |
| Total liabilities measured at fair value | \$ 2,470 | \$ | \$ | \$ 2,470 |

| | As of December 31, 2013 | | | |
|-------------------------------------|-------------------------|-----------|-----------|---------|
| | Aggregate Fair Value | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Money market accounts | \$ 81,548 | \$ 81,548 | \$ | \$ |
| Commercial paper | 54,429 | | 54,429 | |
| Total assets measured at fair value | \$ 135,977 | \$ 81,548 | \$ 54,429 | \$ |

The Company's investments classified as level 2 are priced using quoted market prices for identical assets which are subject to infrequent transactions. Cash equivalents consist of balances in money market accounts which are classified as a level 1 measurement based on bank reporting. The Company reassesses the fair value of contingent consideration to be settled in cash related to the WebDAM acquisition on a quarterly basis using the Monte-Carlo simulation approach. This contingency is considered a level 3 measurement. Significant assumptions used in the measurement include probabilities of achieving certain milestones and discount rates which are based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value. As a result of a shorter discounting period, the Company recorded a change in the fair value of the contingent consideration in the amount of \$70 and \$110 during the three and nine months ended September 30, 2014, respectively, which is included in other (expense) income, net. As of September 30, 2014, the fair value of the contingent consideration increased to \$2,470 based on its current fair value and is included in other non-current liabilities.

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

(3) Information About Revenue By Geographic Area

The following table presents the Company's revenue based on customer location:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------|-------------------------------------|-----------|------------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| North America | \$ 31,569 | \$ 21,556 | \$ 87,896 | \$ 60,762 |
| Europe | 28,519 | 20,746 | 83,452 | 59,927 |
| Rest of the world | 23,642 | 17,256 | 65,397 | 46,795 |
| Total revenue | \$ 83,730 | \$ 59,558 | \$ 236,745 | \$ 167,484 |

Included in North America is the United States which comprises 32% and 32% of total revenue for the three months ended September 30, 2014 and 2013, respectively, and 32% and 32% of total revenue for the nine months ended September 30, 2014 and 2013, respectively. No other country accounts for more than 10% of the Company's revenue in any period. All long-lived assets are located in the United States.

(4) Goodwill and Intangible Assets

The Company's goodwill balance is attributable to its Bigstockphoto, Inc. (Bigstock) and WebDAM reporting units and is tested for impairment at least annually on October 1 or upon a triggering event. The following table summarizes the changes in the Company's goodwill balance through September 30, 2014:

Table of Contents

| | Bigstock | WebDAM | Consolidated |
|----------------------------------|----------|----------|--------------|
| Balance as of December 31, 2013 | \$ 1,423 | \$ | \$ 1,423 |
| Goodwill related to acquisition | | 8,763 | 8,763 |
| Balance as of September 30, 2014 | \$ 1,423 | \$ 8,763 | \$ 10,186 |

Intangible assets consist of the following as of September 30, 2014 and December 31, 2013:

| | Gross Carrying Amount | As of September 30, 2014 Accumulated Amortization | Net Carrying Amount | Weighted Average Life (Years) |
|--------------------------------------|-----------------------|--|---------------------|-------------------------------|
| Amortizing intangible assets: | | | | |
| Customer relationship | \$ 3,400 | \$ (821) | \$ 2,579 | 6 |
| Trade name | 900 | (198) | 702 | 9 |
| Developed technology | 600 | (47) | 553 | 7 |
| Contributor content | 450 | (151) | 299 | 15 |
| Patents | 193 | (27) | 166 | 17 |
| Domain name | 97 | (17) | 80 | 14 |
| Total(1) | \$ 5,640 | \$ (1,261) | \$ 4,379 | |

(1): During the three months ended September 30, 2014, the Company acquired the non-exclusive licensing rights to distribute digital content in perpetuity in the amount of \$331. The Company has not yet placed the digital content into service and therefore is excluded from the table.

| | Gross Carrying Amount | As of December 31, 2013 Accumulated Amortization | Net Carrying Amount | Weighted Average Life (Years) |
|--------------------------------------|-----------------------|---|---------------------|-------------------------------|
| Amortizing intangible assets: | | | | |
| Customer relationship | \$ 600 | \$ (600) | \$ | 4 |
| Trade name | 400 | (119) | 281 | 14 |
| Contributor content | 450 | (127) | 323 | 15 |
| Patents | 193 | (21) | 172 | 17 |
| Domain name | 86 | (9) | 77 | 15 |
| Total | \$ 1,729 | \$ (876) | \$ 853 | |

Table of Contents

Amortization expense was \$167 and \$57 for the three months ended September 30, 2014 and 2013, respectively, and \$384 and \$169 for the nine months ended September 30, 2014 and 2013, respectively. The Company also determined that there was no indication of impairment for the intangible assets for all periods presented. Estimated amortization expense for the next five years is: \$166 for the remaining three months of 2014, \$665 in 2015, \$665 in 2016, \$665 in 2017, \$634 in 2018 and \$1,584 thereafter.

(5) Property and Equipment

Property and equipment is summarized as follows:

| | September 30, 2014 | December 31, 2013 |
|---------------------------------|-----------------------|----------------------|
| Computer equipment and software | \$ 22,075 | \$ 14,108 |
| Furniture and fixtures | 2,149 | 2,588 |
| Leasehold improvements | 13,932 | 10,669 |
| Property and equipment | 38,156 | 27,365 |
| Less accumulated depreciation | (11,734) | (7,109) |
| Property and equipment, net | \$ 26,422 | \$ 20,256 |

Depreciation expense amounted to \$1,958 and \$956 for the three months ended September 30, 2014 and 2013, respectively, and \$5,373 and \$2,569 for the nine months ended September 30, 2014 and 2013, respectively. Depreciation expense is included in cost of revenue and general and administrative expense based on the nature of the asset. In connection with its move to its new headquarters, the Company recorded a loss on disposal of certain fixed assets in the amount of \$367 for the nine months ended September 30, 2014. There was no loss on disposal for the three months ended September 30, 2014 and 2013 and for the nine months ended 2013.

(6) Accrued Expenses

Accrued expenses consist of the following:

| | September 30, 2014 | December 31, 2013 |
|--------------------------|-----------------------|----------------------|
| Royalty tax withholdings | \$ 6,085 | \$ 5,305 |
| Compensation | 6,527 | 6,379 |
| Non-income taxes | 4,287 | 3,994 |
| Professional fees | 681 | 605 |
| Marketing | 212 | 475 |
| Construction costs | 98 | 4,501 |
| Other expenses | 4,504 | 2,379 |
| Total accrued expenses | \$ 22,394 | \$ 23,638 |

Table of Contents

(7) Income Taxes

The Company's effective tax rates for the three months ended September 30, 2014 and 2013 are 40.3% and 37.7%, respectively. The Company's effective tax rates for the nine months ended September 30, 2014 and 2013 are 42.9% and 39.7%, respectively. The Company incurred a discrete tax expense relating to a change in its state apportionment percentage during the three and nine months ended September 30, 2014, which increased the effective tax rate by 0.1% and 2.3%, respectively. Excluding this discrete expense, the effective rate would have been 40.2% and 40.6%, respectively, for the three and nine months ended September 30, 2014. The Company has computed the provision for income taxes based on the estimated annual effective tax rates and the application of discrete items, if any, in the applicable period. The effective tax rate differs from the statutory tax rate due primarily to non-deductible expenses related to non-cash equity-based compensation, and meals and entertainment.

During the three and nine months ended September 30, 2014, the Company did not record additional unrecognized tax benefits. During the three and nine months ended 2013, the Company recorded an unrecognized tax benefit in the amount of \$2 and \$986, respectively, for uncertain tax positions taken in prior years. To the extent these unrecognized tax benefits are ultimately recognized, the Company's effective tax rate may be impacted in future periods.

The Company recognizes interest expense and tax penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of operations. The Company accrued interest and penalties in the amount of \$25 and \$2 related to unrecognized tax benefits for the three months ended September 30, 2014 and 2013, respectively, and during the nine months ended September 30, 2014 and 2013, the Company accrued interest and penalties in the amount of \$72 and \$13 related to unrecognized tax benefits.

It is the Company's practice and intention to indefinitely reinvest the earnings of its foreign subsidiaries in those operations. As of September 30, 2014, the excess of the amount for financial reporting over the tax basis of investment in these foreign subsidiaries is insignificant and the unrecognized deferred tax liability is not material.

(8) Term Loan Facility

On September 21, 2012, the Company entered into a Loan and Security Agreement with Silicon Valley Bank providing for a \$12,000 term loan facility, which the Company refers to as the term loan facility. On December 24, 2012, the Company paid down \$6,000 of the term loan facility. On March 25, 2013, the Company paid off the remaining \$6,000 of the loan facility.

The Company capitalizes costs directly associated with acquiring third party financing. During the three months ended March 31, 2013, the Company accelerated and recognized \$125 as a result of paying off the term loan facility.

The Company was in compliance with the financial covenants and other covenants applicable to it under the term loan facility during the three months ended March 31, 2013 prior to paying off the term loan facility on March 25, 2013.

(9) Commitments and Contingencies

The Company leases facilities under agreements accounted for as operating leases. Rental expense, inclusive of operating leases, for the three months ended September 30, 2014 and 2013 was \$999 and \$801, respectively, and for the nine months ended September 30, 2014 and 2013 was \$3,167 and \$1,830, respectively. Some leases have defined escalating rent provisions, which are expensed over the term of the related lease on a straight-line basis commencing with the date of possession. Any rent allowance or abatement is netted in this calculation. All leases require payment of real estate taxes and operating expense increases.

On March 21, 2013, the Company entered into an operating lease agreement to lease its new office facility in New York, New York. The Company took possession of the premises during the third quarter of 2013, and as a result, the lease commenced. The Company also entered into a letter of credit in the amount of \$1,829 as a security deposit for the leased facilities. The letter of credit was collateralized by \$1,829 of cash as of September 30, 2014 and December 31, 2013, and as such, is considered to be restricted cash and is included in other assets on the consolidated balance sheet. The lease term is eleven years from the commencement date and aggregate future minimum lease payments are approximately \$38,200.

Capital Expenditures

As of September 30, 2014, the Company had no significant purchase commitments related to capital expenditures. As of December 31, 2013, the Company had committed to purchase approximately \$2,500 of data server equipment and \$3,700 related to completion of its new office facility.

Unconditional Purchase Obligations

As of September 30, 2014 and December 31, 2013, the Company had unconditional purchase obligations in the amount of \$8,453 and \$5,864, respectively, which consisted primarily of contracts related to infrastructure services.

As of September 30, 2014, the Company's unconditional purchase obligations for the remainder of 2014 and for the years ending December 31, 2015, 2016 and 2017 are \$1,790, \$5,021, \$1,578 and \$64, respectively. As of December 31, 2013, the Company's unconditional purchase obligations for the years ending December 31, 2014, 2015 and 2016 are \$3,454, \$1,845 and \$565, respectively.

Legal Matters

From time to time, the Company may become party to litigation in the ordinary course of business, including direct claims brought by or against the Company with respect to intellectual property, contracts, employment and other matters, as well as claims brought against the Company's customers for whom the Company has a contractual indemnification obligation. The Company assesses the likelihood of any adverse judgments or outcomes with respect to these matters and determines loss contingency assessments on a gross basis after assessing the probability of incurrence of a loss and whether a loss is reasonably estimable. In addition, the Company considers other relevant factors that could impact its ability to reasonably estimate a loss. A determination of the amount of reserves required, if any, for these contingencies is made after analyzing each matter. The Company reviews reserves, if any, at least quarterly and may change the amount of any such reserve in the future due to new developments or changes in strategy in handling these matters. Although the results of litigation and threats of litigation, investigations and claims cannot be predicted with certainty, the Company currently believes that the final outcome of these matters will not have a material adverse effect on its business, consolidated financial position, results of operations, or cash flows. Regardless of

Edgar Filing: Shutterstock, Inc. - Form 10-Q

the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors. The Company currently has no material active litigation matters and, as such, no material reserves related to litigation.

Table of Contents

Indemnifications

In the ordinary course of business, the Company enters into contractual arrangements under which it agrees to provide indemnification of varying scope and terms to customers with respect to certain matters, including, but not limited to, losses arising out of the breach of Company's intellectual property warranties for damages to the customer directly attributable to the Company's breach. The Company is not responsible for any damages, costs, or losses to the extent such damages, costs or losses arise as a result of the modifications made by the customer, or the context in which an image is used. The standard maximum aggregate obligation and liability to any one customer for all claims is generally limited to \$10. The Company offers certain of its customers greater levels of indemnification, including unlimited indemnification. As of September 30, 2014 and as of December 31, 2013, the Company has recorded no liabilities related to indemnification obligations in accordance with the authoritative guidance for loss contingencies. Additionally, the Company believes that it has the appropriate insurance coverage in place to adequately cover such indemnification obligations, if necessary.

Employment Agreements

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

(10) Employee Benefit Plans

The Company has a 401(k) defined contribution plan ("401(k) Plan") and provides for annual discretionary employer matching contributions not to exceed 3% of employees' compensation per year. Matching contributions are fully vested and non-forfeitable at all times.

The Company recorded employer matching contributions of \$264 and \$186 for the three months ended September 30, 2014 and 2013, respectively, and \$710 and \$503 for the nine months ended September 30, 2014 and 2013, respectively.

(11) Equity-Based Compensation

Stock Option Awards

The following table presents a summary of the Company's stock option awards activity for the nine months ended September 30, 2014:

Edgar Filing: Shutterstock, Inc. - Form 10-Q

| | Plan Options | Weighted Average Exercise Price |
|--|-----------------|------------------------------------|
| Options outstanding at December 31, 2013 | 1,861,761 | \$ 26.09 |
| Options granted | 542,750 | 74.52 |
| Options exercised | (338,549) | 19.72 |
| Options cancelled or forfeited | (108,204) | 44.57 |
| Options outstanding at September 30, 2014 | 1,957,758 | \$ 39.62 |
| Vested and exercisable at September 30, 2014 | 632,994 | \$ 20.56 |

The intrinsic value of the total stock options outstanding at September 30, 2014 and at December 31, 2013 was approximately \$62,200 and \$107,100, respectively. The intrinsic value of the total stock options vested and exercisable at September 30, 2014 and at December 31, 2013 was approximately \$32,200 and \$38,900, respectively.

Table of Contents

There were no stock options granted during the three months ended September 30, 2014. The following weighted average assumptions were used in the fair value calculation of stock options granted during the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------|-------------------------------------|----------|------------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Expected term (in years) | | 6.3 | 6.3-10 | 6.3 |
| Volatility | % | 49% | 49% | 49% |
| Risk-free interest rate | % | 1.0-1.5% | 2.1-2.8% | 1.0-1.5% |
| Dividend yield | % | 0% | 0% | 0% |

On April 24, 2014, the Company granted 500,000 stock options with a market-based condition to its Chief Executive Officer (CEO). The stock options have an exercise price of \$80.94 per share and will not vest or become exercisable unless (i) the CEO remains continuously employed by the Company until the fifth anniversary of the date of grant and (ii) the average 90-day closing price of the Company's common stock equals or exceeds \$161.88 for any 90 consecutive calendar days during the period commencing on the fifth anniversary of the date of grant and ending on the tenth anniversary of the date of grant, inclusive provided that the CEO remains continuously employed by the Company until the date of satisfaction of such condition. The derived requisite service period was determined to be six years based on a valuation technique. The total fair value of the grant is \$21,630 and is being recognized over the derived requisite service period. In the event that the market condition remains unsatisfied upon completion of the requisite service period, no charge will be reversed.

The Company recognized non-cash equity-based compensation expense of \$2,197 and \$1,425, net of forfeitures, in connection with the vesting of stock options during the three months ended September 30, 2014 and 2013, respectively. The Company recognized non-cash equity-based compensation expense of \$5,925 and \$3,169, net of forfeitures, in connection with the vesting of stock options during the nine months ended September 30, 2014 and 2013, respectively. As of September 30, 2014, the total unrecognized compensation charge related to 2012 Plan non-vested options is approximately \$31,700, which is expected to be recognized through fiscal year 2020.

Restricted Stock Unit and Restricted Stock Awards

The following table presents a summary of the Company's RSUs activity for the nine months ended September 30, 2014:

| | Plan Options | Weighted Average Fair Value |
|--|-----------------|--------------------------------|
| Non-vested balance at December 31, 2013 | 10,000 | \$ 47.17 |
| Units granted | 640,975 | 83.19 |
| Units vested | (3,125) | 47.17 |
| Units cancelled or forfeited | (18,850) | 81.36 |
| Non-vested balance at September 30, 2014 | 629,000 | \$ 82.85 |

The Company recognized non-cash stock-based compensation expense of \$3,234 and \$30, net of estimated forfeitures, in connection with the vesting of RSUs during the three months ended September 30, 2014 and 2013, respectively. The Company recognized non-cash stock-based compensation expense of \$7,518 and \$48, net of estimated forfeitures, in connection with the vesting of RSUs during the nine months ended September 30, 2014 and 2013, respectively.

In connection with the Reorganization, membership interest in the LLC was exchanged for restricted and unrestricted shares of the Company's stock. The Amended and Restated Restricted Stock Agreement entered into by the Company with an executive governs the terms of the restricted stock inclusive of service vesting terms. As the restricted shares vest, the award's restrictions will be removed. The Company recognized non-cash equity-based compensation expense of \$259, which is included in general and administrative expense, during the three months ended September 30, 2014 and 2013, in connection with the normal vesting of restricted stock. The Company recognized non-cash equity-based compensation expense of \$777, which is included in general and administrative expense, during the nine months ended September 30, 2014 and 2013, in connection with the normal vesting of restricted stock.

In connection with the WebDAM acquisition, in order to retain the services of certain former WebDAM employees, the Company granted non-vested RSUs that will vest over two years from the date of acquisition. As these equity awards are subject to post-acquisition employment, the Company accounts for them as compensation expense. A portion of these equity awards are accounted for as liability-classified awards, because the obligations are based on fixed monetary amounts that are known at the inception of the obligation, to be settled with a variable number of shares of the Company's common stock when the equity awards vest. The Company recognized non-cash stock-based compensation expense of \$419 and \$910, respectively, in connection with the vesting of these obligations during the three and nine months ended September 30, 2014, respectively. There was no non-cash stock-based compensation expense related to these obligations during the three and nine months ended September 30, 2013.

Table of Contents

On April 24, 2014, the Company granted 100,000 RSUs with a market-based condition to its Chief Executive Officer (CEO). The RSUs will not vest or become exercisable unless (i) the CEO remains continuously employed by the Company until the fifth anniversary of the date of grant and (ii) the average 90-day closing price of the Company's common stock equals or exceeds \$161.88 for any 90 consecutive calendar days during the period commencing on the fifth anniversary of the date of grant and ending on the tenth anniversary of the date of grant, inclusive provided that the CEO remains continuously employed by the Company until the date of satisfaction of such condition. The derived requisite service period was determined to be six years based on a valuation technique. The total fair value of the grant is \$5,870 and is being recognized over the derived requisite service period. In the event that the market condition remains unsatisfied upon completion of the requisite service period, no charge will be reversed.

As of September 30, 2014, the total unrecognized non-cash stock-based compensation charge related to the 2012 Plan non-vested restricted stock and RSUs is approximately \$47,300, which is expected to be recognized through fiscal year 2020.

Employee Stock Purchase Plan

On October 10, 2012, the Company's 2012 ESPP became effective. The Company recognized non-cash stock-based compensation expense of \$225 and \$138, net of estimated forfeitures, for the three months ended September 30, 2014 and 2013, respectively. The Company recognized non-cash stock-based compensation expense of \$598 and \$428, net of estimated forfeitures, for the nine months ended September 30, 2014 and 2013. As of September 30, 2014, 112,030 shares of the Company's common stock have been issued under the 2012 ESPP.

The following table summarizes non-cash equity-based compensation expense included in the Company's statement of operations for the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------|----------------------------------|----------|---------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Cost of revenue | \$ 336 | \$ 126 | \$ 953 | \$ 291 |
| Sales and marketing | 819 | 358 | 2,689 | 865 |
| Product development | 1,805 | 406 | 4,529 | 990 |
| General and administrative | 3,374 | 962 | 7,557 | 2,276 |
| Total | \$ 6,334 | \$ 1,852 | \$ 15,728 | \$ 4,422 |

Table of Contents

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

Safe Harbor Cautionary Statement

The following discussion of our financial condition and results of operations should be read together with our interim consolidated financial statements contained elsewhere in this quarterly report on Form 10-Q and with information contained in our other filings, including the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013.

This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Risk Factors of this Quarterly Report on Form 10-Q and in other parts of this report.

Overview

We operate an industry-leading global marketplace for commercial digital imagery and music. Commercial digital imagery consists of licensed photographs, illustrations and videos that companies use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content while music consists of high-quality music tracks which is often used to complement the digital imagery. Demand for commercial digital imagery and music comes primarily from businesses, marketing agencies and media organizations.

Our global online marketplace brings together users of commercial digital imagery and music with creators from around the world. More than one million active, paying users contributed to revenue through September 30, 2014. We have historically benefitted from a high degree of revenue retention from both subscription-based and On Demand customers. For example, in 2013, 2012 and 2011, we experienced year-to-year revenue retention of 99%, 100%, and 102%, respectively. This means that customers that contributed to revenue in 2012 contributed, in the aggregate, 99% as much revenue in 2013 as they did in 2012. More than 60,000 approved contributors make their images available in our collection, which has grown to more than 40 million images as of September 30, 2014. This makes our collection one of the largest of its kind and, in the twelve months ended December 31, 2013, we delivered more than 100 million paid downloads (including both commercial and editorial images) to our customers. We believe that we delivered the highest volume of commercial image downloads in this period of any single brand in our industry.

- In February 2014, we announced a partnership with the New York based Art Directs Club (ADC) that will further both organizations' commitment to empowering the creative community. The Company will serve as partner in presenting ADC's highly regarded programs and initiatives including Young Guns, Portfolio Night and the Tomorrow Awards.

- In February 2014, we surpassed contributor payouts of \$200 million since our founding in 2003, illustrating our dynamic global marketplace and ability to connect artists to image buyers around the world.

Edgar Filing: Shutterstock, Inc. - Form 10-Q

- In March 2014, we acquired certain assets and liabilities of Virtual Moment, LLC (dba WebDAM) (WebDAM). WebDAM sells digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. WebDAM's products help organizations manage, search, distribute and collaborate on creative files in order to grow its brands and reach new audiences.
- In April 2014, we surpassed over 400 million licenses sold since our founding in 2003, highlighting our increasing role in powering business communications worldwide.
- In June 2014, we announced the launch of Shutterstock Music. This new product features thousands of high-quality audio tracks available through our strategic partner and offers simple and affordable license options, making it easier for businesses, marketers, producers and filmmakers to add quality sounds to commercial videos.
- In July 2014, we launched a new image discovery tool called Palette. This latest addition to the Company's Labs Site creates a unique experience for customers searching our collection using color themes.
- In August 2014, we announced that our collection reached 40 million images and in September 2014, we surpassed 2 million video clips in our collection, including 65,000 videos in state-of-the-art 4K.

As an online marketplace, we generate revenue by licensing images, videos and music to our customers. We pay royalties to our contributors for each piece of their content that is downloaded. Approximately half of our revenue and the vast majority of our downloads come from subscription-based customers. These customers can download and use a large number of images in their creative process without concern for the incremental cost of each image download. For

Table of Contents

customers who need fewer images, we offer simple, affordable, On Demand pricing, which is presented as a fixed price across all images, clips and sizes. Since the launch of our On Demand purchase options in 2008, revenue from these purchase options has increased as a percentage of our overall revenue and we expect that this trend will continue.

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

Our cost of revenue is substantially similar as a percentage of revenue for our On Demand and subscription-based purchase options. While contributors earn a fixed amount per download for some of our plans, we have set the per-download amount paid to our contributors for each of our purchase options so that contributors earn more per download from plans where we collect higher revenue per download. In other words, we strive to deliver a similar percentage of revenue to contributors regardless of which purchase option a customer chooses. Cost of revenue for our On Demand purchase options has been slightly lower than that of our subscription-based options; however, this difference has historically represented less than 5% of revenue. As a result, we expect that shifts in the relative popularity of these two purchase options will not materially impact our cost of revenue.

We manage customer acquisition costs based on the expected blended customer lifetime value across our purchase options so we are able to manage our marketing expenses to achieve certain desired growth targets. As a result, we do not believe that shifts in the mix between On Demand or subscription-based purchase options will materially impact our operating margins. In addition, the repeat revenue characteristics of customers whose first purchase was a subscription-based purchase option are substantially similar to those whose first purchase was an On Demand purchase option.

An important driver of our growth is customer acquisition, which we achieve primarily through online marketing efforts including paid search, organic search, online display advertising, email marketing, affiliate marketing, social media and strategic partnerships. Over the past several years, we increased our investments in marketing as a percentage of revenue. Since we believe the market for commercial digital imagery and music is at an early stage, we plan to continue to invest aggressively in customer acquisition to achieve revenue and market share growth. We believe that another important driver of growth is the quality of the user experience we provide on our websites, especially the efficiency with which our search interfaces and algorithms help customers find the images, videos and music that they need, the degree to which we make use of the large quantity of data we collect about images, videos and music and search patterns, and the degree to which our websites have been localized for international audiences. To this end, we have also invested aggressively in product development and we plan to continue to invest in this area. Finally, the quality and quantity of content that we make available in our collection is another key driver of our growth. The number of approved and licensable images in the Shutterstock collection exceeded 40 million images as of September 30, 2014, making it one of the largest libraries of its kind.

On March 14, 2014, the Company acquired certain assets and liabilities of Virtual Moment, LLC (dba WebDAM) (WebDAM) pursuant to an asset purchase arrangement. The transaction was accounted for using the acquisition method, and accordingly, the results of the acquired business have been included in the Company's results of operations from the acquisition date. WebDAM sells digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. WebDAM's products help organizations manage, search, distribute and collaborate on creative digital files in order to grow its brands and reach new audiences. WebDAM's offerings are particularly attractive to large enterprises, which make up a significant portion of their client base. We believe that this acquisition will increase our strategic position with our enterprise customers as well as broaden our product availability to seize market opportunity.

Table of Contents**Key Business Metrics**

In addition to key financial metrics, we regularly review a number of key operating metrics to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe that these metrics are useful for understanding the underlying trends in our business. The following table summarizes our key operating metrics, which are unaudited, for the three and nine months ended September 30, 2014 and 2013:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|---------|--|---------|
| | 2014 (in millions, except revenue per download) | 2013 | 2014 (in millions, except revenue per download) | 2013 |
| Paid downloads (during the period) | 31.2 | 25.4 | 92.4 | 72.1 |
| Revenue per download (during the period) | \$ 2.65 | \$ 2.35 | \$ 2.54 | \$ 2.32 |
| Images in collection (end of period) | 42.7 | 29.7 | 42.7 | 29.7 |

Paid Downloads

Measuring the number of paid downloads that our customers make in any given period is important because our revenue and contributor royalties are driven by paid download activity. For customers that choose our On Demand purchase options, each incremental download results in incremental recognition of revenue. For customers that choose our subscription purchase options, we do not recognize revenue from each incremental download, but we believe that download activity is an important measure of the value that a customer is getting from a subscription and the likelihood that the customer will renew. We define paid downloads as the number of downloads that our customers make in a given period of our photographs, vectors, illustrations, video clips or music tracks, excluding re-downloads of images, video clips or music tracks that a customer has downloaded in the past (which do not generate incremental revenue or contributor royalty expense) and downloads of our free image of the week (which we make available as a means of acquiring new customers and attracting existing customers to return to our websites more frequently).

Revenue per Download

We define revenue per download as the amount of revenue recognized in a given period divided by the number of paid downloads in that period. Revenue per download metric excludes the impact of revenue that is not derived or associated with the download of images, video clips or music tracks. This metric captures both changes in our pricing, if any, as well as the mix of purchase options that our customers choose, some of which generate more revenue per download than others. For example, when a customer pays \$49.00 for five On Demand images, we earn more revenue per download (\$9.80) than when a customer purchases a one-month subscription for \$249.00 and downloads 100 images during the month (\$2.49 per download). Over the last three years, revenue from each of our purchase options has grown, however our fastest growing purchase options have been those that generate more revenue per download, most notably our On Demand purchase options. Revenue per download has increased steadily over the last three years, almost entirely due to the change in product mix. During this period, pricing has remained relatively constant.

Images in Collection

We define images in our collection as the total number of photographs, vectors and illustrations available to customers on shutterstock.com at any point in time. We record this metric as of the end of a period. Offering a large selection of images allows us to acquire and retain customers and, therefore, we believe that broadening our selection of high-quality images is an important driver of our revenue growth.

Table of Contents

Key Components of Our Results of Operations

Revenue

The vast majority of our revenue is generated by licensing commercial digital imagery and music. The significant majority of our revenue is generated via either subscription or On Demand purchase options. We generate subscription revenue through the sale of subscriptions varying in length from 30 days to one year. Our most popular subscription offering allows up to 25 image downloads per day for a flat monthly fee. In substantially all cases, we receive the full amount of the subscription payment by credit card at the time of sale; however, subscription revenue is recognized on a straight-line basis over the subscription period. We generate On Demand revenue through the sale of fixed packages of downloads varying in quantity from one image to 25 images, one video clip to 25 video clips or single music tracks. We also generate On Demand revenue through Bigstock via the sale of credits plans (which enable a customer to purchase a fixed number of credits which can then be utilized to download images anytime within one year). We typically receive the full amount of the purchase at the time of sale; however, revenue is recognized as images are downloaded or when the right to download images expires (typically 365 days after purchase). We provide a number of other purchase options which together represented approximately 14% and 10% of our revenue in 2013 and 2012, respectively. These purchase options include custom accounts (for customers that need multi-seat access, invoicing, greater or unlimited indemnification, or a higher volume of images) and video footage (which are sold both individually and in fixed packages). We typically receive the full amount of the purchase at the time of sale; however, revenue is recognized as images, video clips or music tracks are downloaded or when the right to download expires (typically 365 days after purchase). Some of our larger custom accounts are invoiced at or after the time of sale and pay us on credit terms. Some custom accounts pay in quarterly installments over the course of an annual commitment. We also generate revenue through WebDAM which was acquired in March 2014. WebDAM licenses digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. The product offerings typically have a license contract of one year.

Our deferred revenue consists of paid but unrecognized subscription revenue, On Demand revenue, and other revenue. Deferred revenue is recognized as revenue when images, video clips or music tracks are downloaded (On Demand), through the passage of time (subscriptions) or when credits or the right to download images, video clips or music tracks expire, and when all other revenue recognition criteria have been met.

Costs and Expenses

Cost of Revenue. Cost of revenue consists of royalties paid to contributors, credit card processing fees, image and video clip review costs, customer service expenses, the infrastructure costs related to maintaining our websites and associated employee compensation, including non-cash equity-based compensation, bonuses and benefits, allocated facility costs and other supporting overhead costs. We expect that our cost of revenue will increase in absolute dollars in the foreseeable future as our revenue grows.

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

Edgar Filing: Shutterstock, Inc. - Form 10-Q

Product Development. Product development expenses consist of employee compensation, including non-cash equity-based compensation, benefits and bonuses, and expenses related to contractors engaged in product management, design, development and testing of our websites and products. Product development costs also include allocated facility and other supporting overhead costs. We expense product development expenses as incurred, except for costs that are capitalized for certain software development projects that have demonstrated technological feasibility. We expect product development expenses to increase in absolute dollars in the foreseeable future as we continue to invest in developing new products and enhancing the functionality of our existing products.

General and Administrative. General and administrative expenses include employee compensation, including, non-cash equity-based compensation, bonuses and benefits for executive, finance, business development, accounting, legal, human resources, internal information technology, business intelligence and other administrative personnel. In addition, general and administrative expenses include outside legal and accounting services, insurance, facilities costs and other supporting overhead costs. We expect to incur incremental general and administrative expenses to support our growth and to support operating as a public company.

Income Taxes. Historically, we filed our income tax return as a pass through New York limited liability company for federal and state income tax purposes and were subject to taxation on allocable portions of our net income and other taxes based on various methodologies employed by taxing authorities in certain localities. As a limited liability company (LLC), we recognized no federal and state income taxes, as the members of the LLC, and not the entity itself, were subject to income tax on their allocated share of our earnings. On October 5, 2012, we reorganized from a limited liability company to a Delaware corporation. Consequently, our corporate income tax rate has increased significantly now that we are subject to federal, state and additional city income taxes.

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

Our GAAP income taxes are computed using the asset and liability method, under which deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted statutory income tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized.

Table of Contents

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with generally accepted accounting principles in the United States, or GAAP. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires our management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. We evaluate our significant estimates on an ongoing basis, including, but not limited to, estimates related to allowance for doubtful accounts, goodwill, intangibles, non-cash equity-based compensation, income tax provisions and certain non-income tax accruals. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

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

A description of our critical accounting policies that involve significant management judgments appears in our Annual Report on Form 10-K for the year ended December 31, 2013 under Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates. There have been no material changes to our critical accounting policies and estimates as compared to our critical accounting policies and estimates included in our Annual Report on Form 10-K.

Emerging Growth Company

Section 107 of the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act of 1933, as amended, for complying with new or revised accounting standards. However, we have chosen to opt out of any extended transition period, and as a result we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies. Section 107 of the JOBS Act provides that our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

We have chosen to rely on certain reduced reporting requirements provided by the JOBS Act. Specifically, as an emerging growth company, we are not required to, among other things, (i) provide an auditor's attestation report on our system of internal controls over financial reporting pursuant to Section 404, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (iii) comply with any requirement that may be adopted by the Public Company Accounting Oversight Board, or the PCAOB, regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements (auditor discussion and analysis), and (iv) disclose certain executive compensation related items such as the correlation between executive compensation and performance and comparisons of the CEO's compensation to median employee compensation. We will remain an emerging growth company for up to five years following our IPO, although, we would cease to be an emerging growth company upon the earliest of (i) the first fiscal year following the fifth anniversary of our IPO, (ii) the first fiscal year after our annual gross revenue is \$1 billion or more, (iii) the date on which we have, during the previous three-year period, issued more than \$1 billion in non-convertible debt securities, or (iv) the date on which we are deemed to be a large accelerated filer as defined in the Exchange Act.

Table of Contents**Results of Operations**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|-----------|---------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| | (in thousands) | | (in thousands) | |
| Consolidated Statements of Operations: | | | | |
| Revenue | \$ 83,730 | \$ 59,558 | \$ 236,745 | \$ 167,484 |
| Operating expenses: | | | | |
| Cost of revenue | 33,260 | 22,936 | 94,419 | 64,525 |
| Sales and marketing | 21,122 | 14,947 | 60,890 | 40,240 |
| Product development | 9,870 | 5,685 | 26,922 | 15,300 |
| General and administrative | 10,588 | 6,076 | 26,922 | 16,590 |
| Total operating expenses | 74,840 | 49,644 | 210,326 | 136,655 |
| Income from operations | 8,890 | 9,914 | 26,419 | 30,829 |
| Other (expense) income, net | (50) | 20 | (48) | 29 |
| Income before income taxes | 8,840 | 9,934 | 26,371 | 30,858 |
| Provision for income taxes | 3,562 | 3,740 | 11,315 | 12,238 |
| Net income | \$ 5,278 | \$ 6,194 | \$ 15,056 | \$ 18,620 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|------|---------------------------------|------|
| | 2014 | 2013 | 2014 | 2013 |
| Consolidated Statements of Operations: | | | | |
| Revenue | 100% | 100% | 100% | 100% |
| Operating expenses: | | | | |
| Cost of revenue | 40 | 39 | 40 | 39 |
| Sales and marketing | 25 | 25 | 26 | 24 |
| Product development | 12 | 10 | 11 | 9 |
| General and administrative | 13 | 10 | 12 | 10 |
| Total operating expenses | 90 | 84 | 89 | 82 |
| Income from operations | 10 | 16 | 11 | 18 |
| Other (expense) income, net | (0) | 0 | 0 | 0 |
| Income before income taxes | 10 | 16 | 11 | 18 |
| Provision for income taxes | 4 | 6 | 5 | 7 |
| Net income | 6% | 10% | 6% | 11% |

Table of Contents**Comparison of the Three Months Ended September 30, 2014 and 2013**

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

| | 2014 | Three Months Ended September 30, 2013 (in thousands) | \$ Change | % Change |
|--|-----------|--|-----------|----------|
| Consolidated Statements of Operations Data: | | | | |
| Revenue | \$ 83,730 | \$ 59,558 | \$ 24,172 | 41% |
| Operating expenses: | | | | |
| Cost of revenue | 33,260 | 22,936 | 10,324 | 45 |
| Sales and marketing | 21,122 | 14,947 | 6,175 | 41 |
| Product development | 9,870 | 5,685 | 4,185 | 74 |
| General and administrative | 10,588 | 6,076 | 4,512 | 74 |
| Total operating expenses | 74,840 | 49,644 | 25,196 | 51 |
| Income from operations | 8,890 | 9,914 | (1,024) | (10) |
| Other (expense) income, net | (50) | 20 | (70) | (350) |
| Income before income taxes | 8,840 | 9,934 | (1,094) | (11) |
| Provision for income taxes | 3,562 | 3,740 | (178) | (5) |
| Net income | \$ 5,278 | \$ 6,194 | \$ (916) | (15)% |

Revenue

Revenue increased by \$24.2 million, or 41%, to \$83.7 million in the three months ended September 30, 2014 compared to the same period in 2013. This increase in revenue was primarily attributable to growth in the number of paid downloads and an increase in revenue per download. In the three months ended September 30, 2014 and 2013, respectively, we delivered 31.2 million and 25.4 million paid downloads, and our average revenue per download during these periods increased to \$2.65 from \$2.35. Paid downloads increased primarily due to the acquisition of new customers. Revenue per download increased primarily due to growth in our On Demand offerings, which capture a higher effective price per image. In the three months ended September 30, 2014 compared to the same period in 2013, revenue from North America increased to 38% from 36% while revenue from Europe decreased to 34% from 35% and revenue from the rest of the world decreased to 28% from 29%.

Cost and Expenses

Cost of Revenue. Cost of revenue increased by \$10.3 million, or 45%, to \$33.3 million in the three months ended September 30, 2014 compared to the same period in 2013. Royalties increased \$6.7 million, or 40%, driven by an increase in the number of downloads from customers. We anticipate royalties growing in line with revenues for the remainder of 2014 and beyond, although royalties as a percentage of revenue may vary somewhat from period to period primarily due to the contributor's achievement level of royalty target thresholds. Credit card charges increased by \$0.6 million, or 31%, to \$2.7 million as a result of an increased card volume in the three months ended September 30, 2014. We anticipate credit card charges increasing for the remainder of 2014 and beyond as credit card transaction volume increases. Employee-related expenses increased \$1.2 million, or 66%, driven by an increase in headcount in customer service, content and website operations to support increased customer volume and a more robust hosting infrastructure. Other costs associated with website hosting, content consulting and allocated depreciation and amortization expense increased by \$1.4 million, or 89%, to \$3.0 million in the three months ended September 30, 2014 compared to the same period in 2013.

Sales and Marketing. Sales and marketing expenses increased by \$6.2 million, or 41%, to \$21.1 million in the three months ended September 30, 2014 compared to the same period in 2013. Advertising expenses, the largest component of our sales and marketing expenses, increased by \$2.4 million, or 28%, as compared to the same period in 2013 as a result of increased spending on both affiliate and search advertising and new channels in the current period. We anticipate that our global advertising spend will continue to increase in absolute dollars for the remainder of 2014 and beyond, as we further our international expansion. Employee-related expenses, including travel and entertainment, increased by \$2.9 million, or 58%, driven by an increase in sales and marketing headcount to support our expansion into new markets and increased sales commissions as a result of growing revenue from our direct sales force.

Product Development. Product development expenses increased by \$4.2 million, or 74%, to \$9.9 million in the three months ended September 30, 2014 compared to the same period in 2013. Employee-related expenses increased by \$3.4 million, or 79%, driven by an increase in headcount in product, engineering and quality assurance to support our increasing number of product development initiatives for our websites, as well as ongoing efforts to improve our search capabilities. Consulting costs and hosting costs increased by \$0.4 million, or 85%, primarily due to costs associated with outsourced and internal product development and quality assurance services.

General and Administrative. General and administrative expenses increased by \$4.5 million, or 74%, to \$10.6 million in the three months ended September 30, 2014 compared to the same period in 2013. Employee-related expenses, excluding non-cash equity based compensation, increased by \$0.8 million, or 39%, driven by an increase in headcount in finance, legal, human resources, internal information technology and business intelligence personnel to support the growth in our business and the infrastructure necessary to operate as a public company. Non-cash equity based compensation increased by \$2.4 million to \$3.4 million primarily due to the equity awards granted to our CEO, as well as increases in equity awards granted as a result of the WebDAM acquisition and equity awards to both new and existing employees.

Income Taxes. Income tax expense decreased by \$0.2 million, or 5% to \$3.6 million in the three months ended September 30, 2014 compared to the same period in 2013. Our effective tax rates for the three months ended September 30, 2014 and 2013 are 40.3% and 37.7%, respectively. During the three months ended September 30, 2014, we incurred a net discrete tax expense related primarily due to the filing of our 2013 fiscal period tax return offset by a discrete tax benefit due to a change in state tax rates and our state apportionment percentage increasing our effective tax rate by 0.1%. During the three months ended September 30, 2013, we recognized a discrete tax benefit upon filing our final LLC tax return for the 2012 fiscal period and a change in state tax rates and our state apportionment percentage which decreased our effective tax rate by 2.5%. Excluding these discrete items, the effective rate would have been 40.2% and 40.2% during the three months ended September 30, 2014 and 2013, respectively.

Table of Contents**Comparison of the Nine Months Ended September 30, 2014 and 2013**

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

| | 2014 | Nine Months Ended September 30, 2013 (in thousands) | \$ Change | % Change |
|--|------------|---|------------|----------|
| Consolidated Statements of Operations Data: | | | | |
| Revenue | \$ 236,745 | \$ 167,484 | \$ 69,261 | 41% |
| Operating expenses: | | | | |
| Cost of revenue | 94,419 | 64,525 | 29,894 | 46 |
| Sales and marketing | 60,890 | 40,240 | 20,650 | 51 |
| Product development | 26,922 | 15,300 | 11,622 | 76 |
| General and administrative | 28,095 | 16,590 | 11,505 | 69 |
| Total operating expenses | 210,326 | 136,655 | 73,671 | 54 |
| Income from operations | 26,419 | 30,829 | (4,410) | (14) |
| Other (expense) income, net | (48) | 29 | (77) | (266) |
| Income before income taxes | 26,371 | 30,858 | (4,487) | (15) |
| Provision for income taxes | 11,315 | 12,238 | (923) | (8) |
| Net income | \$ 15,056 | \$ 18,620 | \$ (3,564) | (19)% |

Revenue

Revenue increased by \$69.3 million, or 41%, to \$236.7 million in the nine months ended September 30, 2014 compared to the same period in 2013. This increase in revenue is primarily attributable to growth in the number of paid downloads and an increase in revenue per download. In the nine months ended September 30, 2014 and 2013, respectively, we delivered 92.4 million and 72.1 million paid downloads, and our average revenue per download during these periods increased to \$2.54 from \$2.32. Paid downloads increased primarily due to the acquisition of new customers. Revenue per download increased primarily due to growth in our On Demand offerings, which capture a higher effective price per image. In the nine months ended September 30, 2014 compared to the same period in 2013, revenue from North America increased to 37% from 36% while revenue from Europe decreased to 35% from 36% while revenue from the rest of the world remained flat at 28%.

Cost and Expenses

Cost of Revenue. Cost of revenue increased by \$29.9 million, or 46%, to \$94.4 million in the nine months ended September 30, 2014 compared to the same period in 2013. Royalties increased \$18.9 million, or 40%, driven by an increase in the number of downloads from customers. We anticipate royalties growing in line with revenues for the remainder of 2014 and beyond, although royalties as a percentage of revenue may vary somewhat from period to period primarily due to the contributor's achievement level of royalty target thresholds. Credit card charges increased by \$2.2 million, or 37%, to \$8.0 million as a result of an increased card volume in the nine months ended September 30, 2014. We anticipate credit card charges increasing for the remainder of 2014 and beyond as credit card transaction volume increases. Employee-related expenses increased by \$3.4 million, or 75%, driven by an increase in headcount in customer service, content and website operations to support increased customer volume and a more robust hosting infrastructure. Other costs associated with website hosting, content consulting and allocation of depreciation and amortization expense increased by \$4.0 million, or 89%, to \$8.4 million in the nine months ended September 30, 2014 as compared to the same period in 2013.

Sales and Marketing. Sales and marketing expenses increased by \$20.7 million, or 51%, to \$60.9 million in the nine months ended September 30, 2014 compared to the same period in 2013. Advertising expenses, the largest component of our sales and marketing expenses, increased by \$8.8 million, or 36%, as compared to the same period in 2013 as a result of increased spending on affiliate and search advertising and new channels in the current period. We anticipate that our global advertising spend will continue to increase in absolute dollars for the remainder of 2014 and beyond, as we further our international expansion. Employee-related expenses, including travel and entertainment, increased by \$9.4 million, or 74%, driven by an increase in sales and marketing headcount to support our expansion into new markets and increased sales commissions as a result of an increase revenue from our direct sales force.

Table of Contents

Product Development. Product development expenses increased by \$11.6 million, or 76%, to \$26.9 million in the nine months ended September 30, 2014 compared to the same period in 2013. Employee-related expenses increased by \$9.2 million, or 81%, driven by an increase in headcount in product, engineering and quality assurance to support our increasing number of product development initiatives for our websites, as well as ongoing efforts to improve our search capabilities. Consulting costs and hosting costs increased by \$1.3 million, or 92%, primarily due to costs associated with outsourced and internal product development and quality assurance services.

General and Administrative. General and administrative expenses increased by \$11.5 million, or 69%, to \$28.1 million in the nine months ended September 30, 2014 compared to the same period in 2013. Employee-related expenses, excluding non-cash equity based compensation, increased by \$2.0 million, or 35%, driven by an increase in headcount in finance, legal, human resources, internal information technology and business intelligence personnel to support the growth of our business and the infrastructure necessary to operate as a public company. Non-cash equity based compensation increased by \$5.3 million to \$7.6 million primarily due to the equity awards granted to our CEO as well as increases in equity awards granted as a result of the WebDAM acquisition and equity awards to both new and existing employees. Professional fees and depreciation expense increased by \$2.4 million, or 78%, primarily due to tax and legal fees incurred as the result of our international expansion and increased property and equipment as a result of our new office facilities. Transaction costs increased \$0.4 million as a result of the WebDAM acquisition. Costs related to our re-location to our new office facility, including exit, disposal, and moving costs, increased \$0.4 million.

Income Taxes. Income tax expense decreased by \$0.9 million, or 8%, to \$11.3 million in the nine months ended September 30, 2014 compared to the same period in 2013. Our effective tax rates for the nine months ended September 30, 2014 and 2013 are 42.9% and 39.7%, respectively. During the nine months ended September 30, 2014, we incurred a discrete tax expense related primarily to a change in state tax rates and our state apportionment percentage increasing our effective tax rate by 2.3%. During the nine months ended September 30, 2013, we incurred a discrete tax expense primarily to a change in state tax rates and our state apportionment percentage offset by a discrete tax benefit recognized upon filing our final LLC tax return for the 2012 fiscal period. These discrete items decreased our effective tax rate by 0.1% during the nine months ended September 30, 2013. Excluding these discrete items, the effective rate would have been 40.6% and 39.6% during the nine months ended September 30, 2014 and 2013, respectively.

Quarterly Trends

Our operating results may fluctuate from quarter to quarter as a result of a variety of factors, including, but not limited to, the effects of some seasonal trends in customer behavior. For example, we expect usage to decrease during the fourth quarter of each calendar year due to the year-end holiday vacation season, and to increase in the first quarter of each calendar year as many customers return to work. While we believe these seasonal trends have affected and will continue to affect our quarterly results, our trajectory of rapid growth may have overshadowed these effects to date. Additionally, because a significant portion of our revenue is derived from repeat customers who have purchased subscription plans, our revenues tend to be smoother and less volatile than if we had no subscription-based customers.

In addition, expenditures on digital imagery by customers tend to be discretionary in nature, reflecting overall economic conditions, the economic prospects of specific industries, budgeting constraints and buying patterns and a variety of other factors, many of which are outside our control. As a result of these and other factors, the results of any prior quarterly or annual periods should not be relied upon as indications of our future operating performance.

Liquidity and Capital Resources

As of September 30, 2014, we had cash and cash equivalents of \$210.8 million, which consists primarily of money market mutual funds and checking accounts. Additionally, we held short-term investments in the amount of \$49.7 million all of which mature in 90 days or less. Since inception, we have financed our operations primarily through cash flow generated from operations. Historically, our principal uses of cash have been funding our operations, capital expenditures, business acquisitions, and distributions to members.

Our initial public offering in 2012 and subsequent follow-on offering in 2013 raised approximately \$147.7 million. We plan to finance our operations and capital expenses largely through our operations. Since our results of operations are sensitive to the level of competition we face, increased competition could adversely affect our liquidity and capital resources, by reducing both our revenues and our net income, as a result of reduced sales, reduced prices and increased promotional activities, among other factors, as well as by requiring us to spend more money on advertising and marketing in an effort to maintain or increase market share in the face of such competition. In addition, the advertising and marketing expenses used to maintain market share and support future revenues will be funded from current capital resources or from borrowings or equity financings. As a result, our ability to grow our business relying largely on funds from our operations is sensitive to competitive pressures and other risks relating to our liquidity or capital resources.

We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination relating to our dividend policy will be made at the discretion of our board of directors, based on our financial condition, results of operations, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant.

Table of Contents

Sources and Uses of Funds

We believe, based on our current operating plan, that our cash and cash equivalents, and cash from operations, will be sufficient to meet our anticipated cash needs for at least the next 12 months. Consistent with previous periods, we expect that future capital expenditures will primarily relate to acquiring additional servers and network connectivity hardware and software, leasehold improvements and furniture and fixtures related to office expansion and relocation and general corporate infrastructure. We anticipate capital expenditures of approximately \$4 million for the remainder of 2014. See Note 9 to our Unaudited Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for information regarding capital expenditures for the nine months ended September 30, 2014 and 2013.

Cash Flows

Operating Activities

Our primary source of cash from operating activities is cash collections from our customers. The majority of our revenues are generated from credit card transactions and are typically settled within one to five business days. Our primary uses of cash for operating activities are for settlement of accounts payable to contributors, vendors and employee-related expenditures.

In the nine months ended September 30, 2014, net cash provided by operating activities was \$59.5 million including net income of \$15.1 million and non-cash equity-based compensation of \$15.7 million. Cash inflows from changes in operating assets and liabilities included an increase in deferred revenue of \$18.7 million, primarily related to an increase in purchases for both subscription and On Demand products. Accounts payable and other operating liabilities increased by \$8.0 million as trade payables grew in volume and payroll costs increased due to headcount expansion. Contributor royalties payable increased by \$3.1 million due to increasing royalty expenses as the result of increased customer download activity.

Investing Activities

Cash used in investing activities in the nine months ended September 30, 2014 was \$21.8 million consisting of capital expenditures to purchase software and equipment related to our data centers, as well as capitalization of leasehold improvements and software and website development costs in the amount of \$16.3 million. We also paid \$10.1 million to acquire certain assets and certain liabilities of WebDAM and paid \$0.3 million to acquire the non-exclusive licensing rights to distribute digital content in perpetuity. Additionally, we sold short-term investments, net of purchases, in the amount of \$4.7 million.

Financing Activities

Edgar Filing: Shutterstock, Inc. - Form 10-Q

Cash provided by financing activities in the nine months ended September 30, 2014 was \$17.8 million consisting of proceeds in the amount of \$7.6 million from the issuance of common stock in connection with the exercise of stock options and purchase of common stock pursuant to our 2012 ESPP and the corresponding excess tax benefit of \$10.2 million as result of the subsequent disposition of the common stock issued.

Table of Contents

Contractual Obligations and Commitments

We lease office facilities under operating lease agreements that expire on various dates between 2014 and 2024. We also have several co-location agreements with third-party hosting facilities that expire between 2014 and 2017. We do not have any material capital lease obligations, and our property, equipment and software have been purchased primarily with cash. We anticipate expanding our office and co-location facilities as our revenue and customer base continue to grow and diversify.

On March 21, 2013, we entered into an operating lease agreement to lease our office facility in New York City. The lease commenced in August 2013 and has a lease term of 11 years. The aggregate future minimum lease payments are approximately \$38.2 million. The Company also entered into a letter of credit in the amount of \$1.8 million as a security deposit for the leased facility. The letter of credit is collateralized by \$1.8 million of cash as of September 30, 2014, and as such, is reported as restricted cash on the consolidated balance sheet as of September 30, 2014.

As of September 30, 2014, our unconditional purchase obligations for the remainder of 2014 and for the years ending December 31, 2015, 2016 and 2017 are \$1,790, \$5,021, \$1,578 and \$64, respectively.

Off-Balance Sheet Arrangements

As of September 30, 2014, we did not have any off-balance sheet arrangements.

Table of Contents

Item 3: Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Fluctuation Risk

Our investments include cash, cash equivalents and short-term investments which consist of commercial paper. Our cash and cash equivalents consist of cash and money market accounts. The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Because our cash, cash equivalents and short-term investments have a maximum term of ninety days, our portfolio's fair value is not particularly sensitive to interest rate changes. We do not enter into investments for speculative purposes. We determined that the nominal difference in basis points for investing our cash, cash equivalents and short-term investments in longer-term investments did not warrant a change in our investment strategy. In future periods, we will continue to evaluate our investment policy in order to ensure that we continue to meet our overall objectives.

We do not have any borrowings as of September 30, 2014.

Foreign Currency Exchange Risk

Revenues derived from customers residing outside North America as a percentage of total revenue was 62% and 64% for the three months ended September 30, 2014 and 2013, respectively, and 63% and 64% for the nine months ended September 30, 2014 and 2013, respectively. Our sales to international customers are denominated in multiple currencies, including but not limited to the U.S. Dollar, the Euro, the British Pound and the Yen. Revenue denominated in foreign currencies as a percentage of total revenue was 32% and 33% for the three and nine months ended September 30, 2014, respectively, and 33% for both the three and nine months ended September 30, 2013, respectively. We have foreign currency exchange risks related to non-U.S Dollar denominated revenues. All amounts earned by and paid to our foreign contributors are denominated in the U.S. Dollar and therefore do not create foreign currency exchange risk. However, changes in exchange rates will affect our revenue and certain operating expenses, primarily employee-related expenses for our non-U.S employees. Based on our foreign currency denominated revenue for the three and nine months ended September 30, 2014, a 10% change in the exchange rate of the U.S. Dollar against all foreign currency denominated revenues would result in an approximately 3% impact on our revenue.

Because the majority of our revenue and expenses are incurred in the U.S. Dollar, we have not experienced material fluctuations in our net income as a result of foreign currency transaction gains or losses. During the three and nine months ended September 30, 2014 and 2013, our foreign currency transaction gains and losses were immaterial. At this time we do not, but we may in the future, enter into derivatives or other financial instruments in order to hedge our foreign currency exchange risk. It is difficult to predict the impact hedging activities would have on our results of operations.

Edgar Filing: Shutterstock, Inc. - Form 10-Q

The Company has established foreign subsidiaries in various countries around the world, and as a result the financial statements of these recently created foreign subsidiaries are recorded in the applicable foreign currency (functional currencies). Financial information is translated from the applicable functional currency to the U.S. Dollar (the reporting currency) for inclusion in the Company's consolidated financial statements. Income, expenses and cash flows are translated at average exchange rates prevailing during the fiscal period, and assets and liabilities are translated at fiscal period-end exchange rates. Resulting translation adjustments are included as a component of accumulated other comprehensive income (loss) in stockholders' equity. During the three and nine months ended September 30, 2013, our foreign subsidiaries did not have any material activity and therefore we did not have any foreign currency translation adjustment during these periods. During the three and nine months ended September 30, 2014, the Company's foreign currency transaction activity was immaterial to its financial statements.

Inflation Risk

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

Table of Contents

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. 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, 2014, 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 were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed with SEC on February 28, 2014, which could materially affect our business, financial condition or future results. There are no material changes to the risk factors described in our Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There has been no material change in the planned use of proceeds from the Company's IPO and follow-on offering from that described in the final prospectuses filed with the SEC pursuant to Rule 424(b) on October 11, 2012 and September 20, 2013, respectively. On March 25, 2013, we used a portion of our IPO proceeds, together with a portion of our cash from operations, to pay off the remaining outstanding balance of \$6.0 million on our term loan facility. See Part II, Item 7 of the Annual Report on Form 10-K under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

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

Table of Contents

SIGNATURES

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

SHUTTERSTOCK, INC.

Dated: November 7, 2014

By: /s/ Jonathan Oringer
Jonathan Oringer
Chief Executive Officer
(Principal Executive Officer)

Dated: November 7, 2014

By: /s/ Timothy E. Bixby
Timothy E. Bixby
Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents

| Exhibit Number | Exhibit Description |
|---------------------------|---|
| 31.1* | Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2* | Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1*# | Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2*# | Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted 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 |

* Furnished herewith.

These certifications are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference in any filing we make under the Securities Act of 1933 or the Securities Exchange Act of 1934, irrespective of any general incorporation language in any filings.

XBRL information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, and is not subject to liability under those sections, is not part of any registration statement or prospectus to which it relates and is not incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.