

Carbonite Inc  
Form 10-K  
March 06, 2013  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2012

OR

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

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

Commission file number: 001-35264

**CARBONITE, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation)

177 Huntington Avenue

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

02115

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**Boston, Massachusetts**  
(Address of principal executive offices)

(Zip Code)

**(617) 587-1100**

(Registrant's telephone number, including area code)

**Securities Registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Exchange on Which Registered</b>
Common Stock, par value \$0.01 per share	The NASDAQ Stock Market LLC

**Securities Registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer

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

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

As of June 29, 2012, the last business day of the registrant's most recently completed second quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$132,139,842.

As of March 1, 2013, there were 25,913,579 shares of the registrant's common stock, par value \$0.01 per share, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

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Portions of the registrant's definitive proxy statement for its 2013 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

**Table of Contents**

**CARBONITE, INC.**

**Table of Contents**

	<b>Page</b>
<b><u>PART I.</u></b>	
	1
	1
Item 1.	2
Item 1A.	9
Item 1B.	30
Item 2.	30
Item 3.	31
Item 4.	31
<b><u>PART II.</u></b>	32
Item 5.	32
Item 6.	34
Item 7.	37
Item 7A.	49
Item 8.	50
Item 9.	75
Item 9A.	75
Item 9B.	78
<b><u>PART III</u></b>	78
Item 10.	78
Item 11.	78
Item 12.	78
Item 13.	78
Item 14.	78
<b><u>PART IV</u></b>	78
Item 15.	78
<b><u>SIGNATURES</u></b>	
<u>Signatures</u>	

---

**Table of Contents**

**PART I**

**SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS**

This Annual Report on Form 10-K (the "Annual Report"), including the sections entitled "Business," "Risk Factors," and "Management's Discussion and Analysis of Financial Condition and Results of Operations," includes forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "predict," "potential," and similar expressions, as well as the negatives thereof, as they relate to us, our business, our management, and our industry, are intended to identify forward-looking statements. In light of risks and uncertainties discussed in this Annual Report, the forward-looking events and circumstances discussed in this Annual Report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. We have based these forward-looking statements 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. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. Important factors that could cause such differences include, but are not limited to:

our ability to accurately forecast revenue and appropriately plan our expenses and working capital requirements;

our ability to generate additional revenue;

our ability to retain existing customers and attract new customers;

our ability to protect our customers' stored files and adequately address privacy concerns;

the impact of actual or threatened litigation, including intellectual property infringement claims, involving us or our industry;

the impact of increased competition in our business;

interruptions in service and any related impact on our reputation;

our ability to maintain, protect, and enhance our brand; and

other risk factors included under "Risk Factors" in this Annual Report.

Forward-looking statements speak only as of the date of this Annual Report. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions, and expectations disclosed in the forward-looking statements we make. In addition, our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments that we may make.

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You should read this Annual Report completely and with the understanding that our actual future results may be materially different from what we expect. We do not assume any obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. 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.

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## **Table of Contents**

Unless otherwise indicated, information contained in this Annual Report concerning our industry and the market in which we operate, including our general expectations and market position, market opportunity, and market size, is based on information from various sources, on assumptions that we have made that are based on such data, and on our knowledge of the markets for our solutions. Such data involves a number of assumptions and limitations, and you are cautioned not to give undue weight to such estimates. In addition, projections, assumptions, and estimates of our future performance and the future performance of the industry in which we operate, whether made by us or by third parties, are necessarily subject to a high degree of uncertainty and risk due to a variety of factors, including those described in Risk Factors and elsewhere in this Annual Report. These and other factors could cause results to differ materially from those expressed in the estimates made by the independent parties and by us.

### **ITEM 1. BUSINESS**

#### **Overview**

Carbonite, Inc. (together with its subsidiaries, Carbonite, the Company, our, we, or us ) was incorporated on February 10, 2005 and is a Delaware corporation. We are a leading provider of cloud backup solutions for consumers and small and medium sized businesses, or SMBs. We provide easy-to-use, affordable, and secure cloud backup solutions with anytime, anywhere access to files stored on our servers. We believe that we are the best known brand in the cloud backup market.

We founded Carbonite on one simple idea: all computers need to be backed up, and in this always-connected and highly-mobile world, cloud backup is the ideal approach. Our set and forget automated solution requires little effort and protects our customers stored files even if their computers are lost, stolen, or destroyed.

Our backup solutions work quietly in the background, automatically and continuously uploading encrypted copies of our customers files to Carbonite servers. Our customers can browse and share their photos, videos, and documents anytime, anywhere using a web browser or our free iPad, iPhone, BlackBerry, and Android apps. We charge consumers a \$59 flat fee for one year of unlimited cloud backup with our Carbonite Home solution. Our Carbonite HomePlus solution provides consumers with additional features, including backup and restore for external hard drives, for an annual flat fee of \$99. The Carbonite HomePremier solution also includes automatic cloud backup for video files as well as a recovery-by-mail feature for an annual flat fee of \$149. The pricing of all of our consumer solutions is discounted for multi-year subscriptions. Our SMB solutions, Carbonite Business and Carbonite BusinessPremier, allow for an unlimited number of users, subject to storage limits, and are priced starting at \$229 and \$599 per year, respectively.

As of December 31, 2012, we had subscribers in more than 100 countries, with subscribers based in the U.S. representing 94% of our total revenue for 2012. Since 2005, we have backed up over 300 billion files and have restored nearly 20 billion files that might otherwise have been permanently lost. We currently back up more than 350 million files each day.

We have developed a highly predictable subscription revenue model, with a consistently high customer retention rate and a scalable infrastructure to support our growth. We generated revenue of \$84.0 million in 2012. We continue to invest heavily in customer acquisition, principally through advertising, and as a result we recorded a net loss of \$18.9 million in 2012. Our bookings have grown from \$32.9 million in 2009 to \$98.5 million in 2012. For a reconciliation of bookings to revenue for the last five years, see Selected Consolidated Financial and Other Data.

#### **Industry Trends**

Cloud backup is gaining increasing acceptance as the best way to store copies of valuable data off-premise, where they are safe from equipment failure, theft, loss, viruses, and accidental deletion.

## **Table of Contents**

Several trends are helping to fuel the growth of the cloud backup industry:

*Your life is on your computer.* Computers and mobile devices have transformed the way people work, communicate, and lead their daily personal and professional lives. People store a plethora of information on their computers and mobile devices, from photos, music, videos, and school work, to financial records, correspondence, passwords, work files, and tax returns. These files could be permanently destroyed due to equipment failure, theft, loss, viruses, and accidental deletions. Often these files are accumulated over time and are irreplaceable, making their loss devastating for the owner.

*Rapid growth in unprotected data drives demand for backup services.* According to IDC, an independent research firm, the proportion of information in the digital universe that requires data protection is growing faster than the digital universe itself.\* From 2005 to 2020, the digital universe is expected to grow by a factor of 300, from 130 exabytes to 40,000 exabytes, or 40 trillion gigabytes (more than 5,200 gigabytes for every man, woman, and child in 2020) and, from 2013 to 2020, the digital universe will about double every two years, according to IDC. Further, while less than a third of the digital universe required data protection in 2010, that proportion is expected to exceed 40% by 2020. According to IDC, only about half the information that should be protected from loss is currently protected.

*Smartphones and tablets drive demand for anytime, anywhere access.* The growing popularity of smartphones, tablet computers, and other mobile devices is driving the demand for instant access to information regardless of a user's location. According to IDC, worldwide tablet shipments reached a record total of 52.5 million units and the tablet market grew 74.3% in the fourth quarter of 2012 up from the third quarter's total of 30.1 million units. Approximately 712.6 million smartphones were shipped globally in 2012, which was 44.1% more than in 2011. IDC predicts that these factors will drive demand for data protection and mobile access.

*Plummeting storage and bandwidth costs.* The cost of providing cloud backup is highly dependent on the cost of storage and bandwidth. According to IDC, between 2012 and 2020, the cost per gigabyte (GB) is expected to drop from \$2.00 to \$0.20. In 2005, the average wholesale cost of bandwidth was approximately \$75 per megabits per second (Mbps) as compared to \$5 per Mbps in 2010, according to an August 2010 study done by DrPeering International. This study projects that the wholesale cost of bandwidth will further decline to approximately \$0.94 per Mbps in 2014.\*\*

\* IDC information was derived from the following reports dated December 2012 and January 2013: IDC Digital Universe Study, Sponsored by EMC, Tablet Shipments Soar to Record Levels During Strong Holiday Quarter; The Digital Universe in 2020: Big Data, Bigger Digital Shadows and Biggest Growth in the Far East, Sponsored by EMC; Strong Demand for Smartphones and Heated Vendor Competition Characterize the Worldwide Mobile Phone Market at the End of 2012, IDC Says.

\*\* DrPeering International: Internet Transit Prices - Historical and Projected, August 2010.



**Table of Contents**

There are multiple alternatives currently available for backing up data, such as external hard disk drives, flash memory drives, CDs, DVDs, and tape backup drives. However, these traditional alternatives are limited by drive capacity, cumbersome to scale, prone to failure, not secure, and not accessible from a remote location. Traditional hardware solutions for storing data have the following limitations:

<b>Limitation</b>	<b>Key Problems</b>
Limited Capacity	Users must select which files to back up
	Cumbersome to add incremental capacity
Susceptible to failure	Unable to protect files in the event of equipment failure, theft, loss, viruses, and accidental deletions
Overly complex	Time consuming and labor intensive to manually manage backup
	Confusing software and processes
Lack of mobile access	Do not provide anytime, anywhere access from computers, smartphones, tablets, and other mobile devices

As a result of these limitations, consumers and SMBs are increasingly searching for simple, affordable solutions that provide reliable and secure cloud backup and anytime, anywhere access to their stored files. We believe that cloud backup effectively addresses the limitations of traditional solutions and will be the predominant backup solution in the future.

**Our Solution**

We provide cloud backup solutions for consumers and SMBs. We believe that our customers buy our solutions because they are easy to use, affordable, and secure, and provide anytime, anywhere access to their stored files. We make it easy for customers to restore their files and we provide high quality customer support to those customers who need assistance.

We believe that our solution provides the following benefits to all of our customers:

*Easy to install and use.* We offer our customers automatic backup, eliminating the need to manually pick and choose which files to back up. Installation requires just an email address and password. Once installed, our set and forget solution works continuously in the background backing up new and changed files.

*Easy to restore files.* In the event of data loss, our restore wizard guides customers through the process of restoring their files. If customers accidentally delete or overwrite files on their Carbonite protected devices, they can quickly restore files from any device with an internet connection.

*Anytime, anywhere access.* We enable customers to access stored files from Carbonite servers anytime, anywhere using a web browser or from any internet-connected device using one of our free iPad, iPhone, BlackBerry, or Android apps. Customers can browse their photos, play music and videos, and view documents, spreadsheets and presentations. Unlike traditional remote desktop applications, we allow our customers to access their stored files even if their computers are turned off, lost, stolen, or destroyed.

*Affordability.* We believe that we were one of the first companies to offer consumers unlimited cloud backup for a fixed price. Our Carbonite Home subscription costs \$59 for one year, with discounts for multi-year plans. Our SMB solutions allows for an unlimited number of users with tiered pricing based on the total amount of data backed up.

## **Table of Contents**

*Security.* We encrypt all of our customers' files before they are transmitted to our data centers, guarding against unauthorized access to stored files and ensuring a high level of data security. In addition, we employ state-of-the-art data center security measures intended to prevent intrusions.

*Reliability.* Our proprietary Carbonite Communications System and Carbonite File System manage our customers' stored files and are designed to ensure high levels of reliability and accessibility.

### **Our Key Competitive Strengths**

We believe that our key competitive strengths include the following:

*Brand awareness.* We believe that we have among the highest brand awareness in the cloud backup market. According to our research surveys, our unaided brand awareness is more than one and a half times that of our nearest competitor. We promote our brand through our multi-channel marketing program, which includes a broad presence in television, radio, online display advertising, print advertising, paid and natural search, and an affiliate and reseller network.

*Scale.* Since 2005, we have backed up over 300 billion files, and we currently back up more than 350 million files each day. We believe that our large scale infrastructure, built over the last seven years, enables us to store additional files at lower incremental cost than our smaller competitors. In addition, we are able to purchase national advertising at advantageous rates, access advertising opportunities that may be unavailable to smaller businesses, and take advantage of sophisticated analytical marketing systems.

*Optimized backup architecture.* Our entire infrastructure is optimized for backup, which is a low transaction speed, high volume, write mostly application. We believe that our average storage costs per subscriber are lower than those realized by typical general purpose data center storage systems.

*Comprehensive customer support.* We believe that our U.S.-based customer support is more comprehensive than that offered by our primary competitors in the cloud backup market and aids in our customer retention. We provide free telephone, live chat, and email customer support in our basic subscription fee.

*Significant intellectual property portfolio.* We have a significant intellectual property portfolio relating to our cloud backup solutions. CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union. Carbonite also has additional registrations and pending applications for additional marks in the U.S. and other countries, including but not limited to Carbonite The Better Backup Plan, Green Dot Logo, Back it up. Get it back, Because Your Life is On Your Computer, Carbonite and the Green Dot Logo, Carbonite Lock Logo and Chinese character representations for Carbonite. In addition, we have four issued patents and 18 pending patent applications in the U.S. and internationally that cover both our technical infrastructure and our key usability and design concepts.

### **Our Offerings**

We offer backup solutions to our customers with anytime, anywhere access to their stored files. We charge consumers a flat fee for one year of unlimited cloud backup at three different service levels, each with discounts for multi-year subscriptions. We offer SMB customers cloud backup for an unlimited number of computers for an annual flat fee based on the total amount of data backed up, with the option to purchase additional incremental storage capacity.

**Table of Contents**

The following table sets forth key features of our Carbonite Home, Carbonite HomePlus, and Carbonite HomePremier consumer offerings:

	<b>Carbonite Home</b>	<b>Carbonite HomePlus</b>	<b>Carbonite HomePremier</b>
Number of computers		One per subscription	
Supported operating systems	Windows, Mac		Windows
Pricing	\$59/year; unlimited storage	\$99/year; unlimited storage, external hard drive backup and restore	\$149/year; unlimited storage, external hard drive backup and restore, automatic backup for video files, recovery-by-mail feature
Subscription Period		Annual or multi-year	
Customer support		U.S.-based telephone, live chat, and email	
Remote file access	Anytime, anywhere using a web browser or our free iPad, iPhone, Blackberry, or Android apps		

The following table sets forth key features of our Carbonite Business and Carbonite BusinessPremier SMB offerings:

	<b>Carbonite Business</b>	<b>Carbonite BusinessPremier</b>
Number of computers		Unlimited
Supported operating systems	Windows	Windows and Windows Server
Pricing	\$229/year; 250 GB of backup storage space	\$599/year; 500 GB of backup storage space
Subscription Period		Annual
Customer support		U.S.-based telephone, live chat, and email
Remote file access	Anytime, anywhere using a web browser or our free iPad, iPhone, Blackberry, or Android apps	

We use sophisticated encryption technology to ensure the privacy of our customers' stored files. We encrypt files using a secure key before the files leave the customer's computer and transmit the encrypted files over the internet to one of our secure data centers. Customers' files remain encrypted on our servers to guard against unauthorized access. We employ outside security analysis firms, including anti-hacking specialists, to review and test our defenses and internal procedures.

**Our Proprietary Server Software**

At the core of our offerings is our proprietary server software designed specifically for cloud backup. The server software is comprised of two major components: the Carbonite Communications System (CCS) and the Carbonite File System (CFS). These components work together to move and store vast amounts of customer data—more than 350 million files every day. CCS moves customer data between our software installed on our customers' computers and CFS running on our storage servers. CCS also balances loads across our server network. CFS manages the write-mostly database of stored files with the flexibility to operate on a wide variety of readily available third-party storage hardware.

We invest heavily in the development of our technologies. In 2012, 2011, and 2010, we spent \$19.9 million, \$16.5 million, and \$10.9 million, respectively, on research and development. Our proprietary technologies are fundamental to our value proposition as they enable us to deliver the following benefits:

*Scalability.* We add storage capacity at the rate of approximately one petabyte every two weeks. CCS allows us to automatically balance processing and storage capacity across our large and expanding server network. CFS allows us to easily add storage capacity across multiple physical locations by automatically integrating new storage servers into our existing infrastructure.

*Reliability.* We designed CCS and CFS to eliminate all single points of failure. The modular design of these components uses well-defined protocols intended to ensure that our customers' stored files are accurate and free from errors. CFS provides proprietary disk error detection for errors that can occur over years of storage. Our software also incorporates checks and balances to verify data integrity.

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## **Table of Contents**

*Cost effectiveness.* Storage cost is the biggest component of our cost of revenue. CCS enables us to dynamically load balance among servers to allow higher overall utilization. CFS enables us to reduce storage costs by utilizing almost every block of physical disk space to store our customers' files. We can choose the most cost-effective hardware solutions for our data centers because CFS allows us to operate in a heterogeneous hardware environment.

### **Marketing and Sales**

Our marketing efforts are focused on three primary goals: building brand awareness, acquiring customers at a low cost, and retaining existing customers. Our advertising reinforces our brand image by emphasizing ease of use, affordability, security, reliability, and anytime, anywhere access to stored files. We use television and radio advertising, online display advertising, print advertising, paid search, direct marketing, and affiliate and reseller marketing. Our public relations efforts include engaging the traditional press, new media, and social networks.

*Marketing.* Most of our revenue is from consumers who sign up for Carbonite backup on our website in response to our direct marketing campaigns. Direct sales from our websites accounted for 96% of our total revenue during 2012. Our marketing efforts are designed to attract prospects to our website and enroll them as paying customers, usually after a 15-day free trial that we offer to consumers. Our SMB sales team responds to inbound qualified SMB leads, communicates the benefits of our solutions to the SMB market and assists our SMB customers to enroll in free trial versions and purchase subscriptions to our SMB offering.

*Channel distribution and reseller strategy.* In January 2012, we launched a new distribution strategy designed to sell large volumes of our solutions through our sales channel relationships including major retailers and resellers.

*Retention.* Our customer retention efforts are focused on establishing and maintaining long-term relationships with our customers by delivering a compelling customer experience and superior value, communicating regularly with customers through email, on-site messaging, and other media, and creating positive interactions with our customer support team. We monitor developing trends in subscription durations, renewals, and customer satisfaction to maximize our customer retention. We offer incentives to customers to purchase multi-year subscriptions, which we believe helps to increase our customer retention. As of December 31, 2012, 2011, and 2010, 29%, 30%, and 24%, respectively, of our customers had multi-year subscriptions.

### **Intellectual Property**

We believe that the strength of our brand and the functionality of our software help differentiate us from our competitors. As such, our success depends upon our ability to protect our technologies and intellectual property, including our proprietary server software, which allows us to move and store vast amounts of customer data. To protect our intellectual property, we rely on a combination of trademark, patent, copyright, and trade secret laws, as well as confidentiality procedures and contractual restrictions. CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union. Carbonite also has additional registrations and pending applications for additional marks in the U.S. and other countries, including but not limited to Carbonite The Better Backup Plan, Green Dot Logo, Back it up. Get it back, Because Your Life is On Your Computer, Carbonite and the Green Dot Logo, Carbonite Lock Logo and Chinese character representations for Carbonite. In addition, we have four issued patents and 18 pending patent applications in the U.S. and internationally that cover both our technical infrastructure and our key usability and design concepts.

The steps we have taken may not adequately protect our intellectual property or prevent unauthorized use of our technologies. Others may independently develop technologies that are competitive to ours or infringe our intellectual property. In addition, costly and time consuming litigation may be necessary to protect and enforce our intellectual property rights.

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## **Table of Contents**

If we become more successful, we believe that competitors will be more likely to try to develop products and services that are similar to ours, and that may infringe our proprietary rights. It may also be more likely that competitors or other third parties will claim that our solutions infringe their proprietary rights.

### **Competition**

We compete with both cloud backup providers and providers of traditional hardware-based backup systems. The market for cloud backup solutions is competitive and rapidly changing. We directly compete with CrashPlan, Mozy (a division of VMWare), SOS Online Backup, and others. Certain of our features, including our mobile backup and remote access service, also compete with current or potential services offered by Apple, Google, Microsoft, Amazon, and others. Certain of our planned features, including the ability to share data with third parties, compete with current or potential services offered by DropBox, SugarSync, Box, and others. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. Many of our actual and potential competitors enjoy competitive advantages over us, such as greater name recognition, longer operating histories, more varied services, and larger marketing budgets, as well as greater financial, technical, and other resources. In addition, many of our competitors have established marketing relationships and major distribution agreements with computer manufacturers, internet service providers, and resellers, giving them access to larger customer bases.

We believe that the key competitive factors in the consumer and SMB backup industry include:

ease of installation and use;

affordability;

remote access;

storage capacity;

security of customers' stored files;

rapid recovery of lost files;

reliability and redundancy;

automated file backup; and

reputation of the provider.

We believe that we compete favorably with respect to each of these factors by providing easy to use, affordable, unlimited, secure cloud backup solutions with anytime, anywhere access to stored files.

Some of our competitors have made or may make acquisitions or enter into partnerships or other strategic relationships to offer a more comprehensive service than we do. These combinations may make it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs, technology, or service functionality. We expect these trends to continue as companies attempt to strengthen or maintain their market positions.

**Employees**

As of December 31, 2012, we had 367 full-time and 11 part-time employees. Of our full-time employees, 195 were in operations and support, 45 were in sales and marketing, 105 were in research and development, and 22 were in general and administrative functions. None of our employees are covered by collective bargaining agreements.

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## **Table of Contents**

### **Available Information**

We file reports with the Securities and Exchange Commission ( SEC ), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and other filings required by the SEC. We make available on our website (www.carbonite.com) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. These materials are available free of charge on or through our website via the Investor Relations page at www.carbonite.com. References to our website address in this report are intended to be inactive textual references only, and none of the information contained on our website is part of this Annual Report or incorporated in this Annual Report by reference.

The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site (<http://www.sec.gov>) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

### **ITEM 1A. RISK FACTORS**

*An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this Annual Report on Form 10-K before making an investment decision. Our business, prospects, financial condition, or operating results could be harmed by any of these risks, as well as other risks not currently known to us or that we currently consider immaterial. The trading price of our common stock could decline due to any of these risks, and, as a result, you may lose all or part of your investment.*

#### **Risks Related to Our Business**

*We have experienced losses and negative cash flow since our inception, and we may not be able to achieve or sustain profitability or positive cash flow in the future.*

We experienced net losses of \$25.8 million for 2010, \$23.5 million for 2011, and \$18.9 million for 2012, respectively, and have an accumulated deficit of \$119.4 million as of December 31, 2012. We do not expect to be profitable for the foreseeable future. We expect to continue making significant expenditures to develop and expand our business, including for advertising, customer acquisition, technology infrastructure, storage capacity, product development, and international expansion, in an effort to increase and service our customer base. In 2012, we incurred increased expenses associated with the relocation of one of our data centers to a new facility. We also expect that our quarterly results may fluctuate due to a variety of factors described elsewhere in this Annual Report on Form 10-K, including the timing and amount of our advertising expenditures, which are seasonal, as well as the timing and amount of expenditures related to the development of technologies and solutions and to defend intellectual property infringement and other claims. In addition, as a public company, we incur significant legal, accounting, and other expenses, including increased costs for director and officer liability insurance that we did not incur as a private company. We may also incur increased losses and negative cash flow in the future for a number of reasons, and we may encounter unforeseen expenses, difficulties, complications, delays, and other unknown events. For these reasons, we expect to continue to record net losses for the next several years and we may not be able to achieve or maintain positive cash flow from operations or profitability.

*Any significant disruption in our service or loss or misuse of our customers' data could damage our reputation and harm our business and operating results.*

Our brand, reputation, and ability to attract, retain, and serve our customers are dependent upon the reliable performance of our service and our customers' ability to readily access their stored files. Our customers rely on our cloud backup solution to store digital copies of their valuable data files, including financial records, business

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**Table of Contents**

information, photos, and other personally meaningful content. Our data centers are vulnerable to damage or interruption from human error, intentional bad acts, computer viruses or hackers, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures, and similar events, any of which could limit our customers' ability to access their files and could prevent us from being able to continuously back up our customers' files. Prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. A breach of our network security and systems could also cause the loss or public disclosure of, or access by third parties to, our customers' stored files. Any event that significantly disrupts our service or exposes our customers' stored files to misuse could damage our reputation and harm our business and operating results, including reducing our revenue, causing us to issue credits to customers, subjecting us to potential liability, harming our renewal rates, or increasing our cost of acquiring new customers.

*The market for cloud backup solutions is competitive, and if we do not compete effectively, our operating results could be harmed.*

We compete with both cloud backup providers and providers of traditional hardware-based backup systems. The market for cloud backup solutions is competitive and rapidly changing. We directly compete with CrashPlan, Mozy (a division of VMWare), SOS Online Backup, and others. Certain of our features, including our mobile backup and remote access service, also compete with current or potential services offered by Apple, Google, Microsoft, Amazon, and others. Certain of our planned features, including the ability to share data with third parties, compete with current or potential services offered by DropBox, SugarSync, Box, and others. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. Many of our actual and potential competitors benefit from competitive advantages over us, such as greater name recognition, longer operating histories, more varied services, and larger marketing budgets, as well as greater financial, technical, and other resources. In addition, many of our competitors have established marketing relationships and major distribution agreements with computer manufacturers, internet service providers, and resellers, giving them access to larger customer bases. Some of our competitors may make acquisitions or enter into strategic relationships to offer a more comprehensive service than we do. These combinations may make it more difficult for us to compete effectively. We expect these trends to continue as competitors attempt to strengthen or maintain their market positions.

Demand for our cloud backup solutions is sensitive to price. Many factors, including our advertising, customer acquisition and technology costs, and our current and future competitors' pricing and marketing strategies, can significantly affect our pricing strategies. Certain of our competitors offer, or may in the future offer, lower-priced or free products or services that compete with our solutions. Similarly, certain competitors may use internet-based marketing strategies that enable them to acquire customers at a lower cost than us. There can be no assurance that we will not be forced to engage in price-cutting initiatives, or to increase our advertising and other expenses to attract and retain customers in response to competitive pressures, either of which could have a material adverse effect on our revenue and operating results.

*Our limited operating history makes it difficult to evaluate our current business and future prospects.*

We have been in existence since 2005, and our revenue has grown rapidly from \$8.2 million in 2008 to \$84.0 million in 2012, representing a compound annual growth rate of 79% over that period. We do not expect that this growth rate will continue in future periods and you should not rely on the revenue growth of any prior quarterly or annual periods as an indication of our future performance. In addition, because we recognize revenue from customers over the terms of their subscriptions, a large portion of our revenue for each quarter reflects deferred revenue from subscriptions entered into during previous quarters, and downturns or upturns in subscription sales or renewals may not be reflected in our operating results until later periods. We may not achieve sufficient revenue to achieve or maintain positive cash flow from operations or profitability, and our limited operating history may make it difficult for you to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing



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## **Table of Contents**

companies in rapidly changing industries, including increasing expenses as we continue to grow our business. If we do not manage these risks successfully, our business will be harmed. If our future growth fails to meet investor or analyst expectations, it could have a negative effect on our stock price. If our growth rate were to decline significantly or become negative, it could adversely affect our financial condition and operating results.

*A decline in demand for our solutions or for cloud backup solutions in general could cause our revenue to decline.*

We derive, and expect to continue to derive, substantially all of our revenue from the sale of our cloud backup solutions, a relatively new and rapidly changing market. As a result, widespread acceptance and use of cloud backup solutions is critical to our future growth and success. If the market for cloud backup solutions fails to grow or grows more slowly than we currently anticipate, demand for our solutions could be negatively affected.

Changes in customer preferences for cloud backup solutions may have a disproportionately greater impact on us than if we offered multiple products and services. The market for cloud backup solutions is subject to rapidly changing customer demand and trends in preferences. Some of the potential factors that could affect interest in and demand for cloud backup solutions include:

awareness of our brand and the cloud backup solutions category generally;

the appeal and reliability of our solutions;

the price, performance, features, and availability of products and services that compete with ours;

public concern regarding privacy and data security;

our ability to maintain high levels of customer satisfaction; and

the rate of growth in online solutions generally.

In addition, substantially all of our revenue is currently derived from customers in the U.S. Consequently, a decrease of interest in and demand for cloud backup solutions in the U.S. could have a disproportionately greater impact on us than if our geographic mix of revenue was less concentrated.

*If we are unable to attract new customers to our solutions on a cost-effective basis, our revenue and operating results would be adversely affected.*

We generate substantially all of our revenue from the sale of subscriptions to our solutions. In order to grow, we must continue to attract a large number of customers on a cost-effective basis, many of whom have not previously used cloud backup solutions. We use and periodically adjust a diverse mix of advertising and marketing programs to promote our solutions. Significant increases in the pricing of one or more of our advertising channels would increase our advertising costs or cause us to choose less expensive and perhaps less effective channels. As we add to or change the mix of our advertising and marketing strategies, we may need to expand into channels with significantly higher costs than our current programs, which could adversely affect our operating results. We may incur advertising and marketing expenses significantly in advance of the time we anticipate recognizing any revenue generated by such expenses, and we may only at a later date, or never, experience an increase in revenue or brand awareness as a result of such expenditures. We have made in the past, and may make in the future, significant investments to test new advertising, and there can be no assurance that any such investments will lead to the cost-effective acquisition of additional customers. If we are unable to maintain effective advertising programs, our ability to attract new customers could be adversely affected, our advertising and marketing expenses could increase substantially, and our operating results may suffer.

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A portion of our potential customers locate our website through search engines, such as Google, Bing, and Yahoo!. Our ability to maintain the number of visitors directed to our website is not entirely within our control. If

## **Table of Contents**

search engine companies modify their search algorithms in a manner that reduces the prominence of our listing, or if our competitors' search engine optimization efforts are more successful than ours, fewer potential customers may click through to our website. In addition, the cost of purchased listings has increased in the past and may increase in the future. A decrease in website traffic or an increase in search costs could adversely affect our customer acquisition efforts and our operating results.

A significant portion of our customers first try our cloud backup solutions through free trials. We seek to convert these free trial users to paying customers of our solutions. If our rate of conversion suffers for any reason, our revenue may decline and our business may suffer.

***If we are unable to retain our existing customers, our revenue and operating results would be adversely affected.***

If our efforts to satisfy our existing customers are not successful, we may not be able to retain them, and as a result, our revenue and ability to grow would be adversely affected. We may not be able to accurately predict future trends in customer renewals. Customers choose not to renew their subscriptions for many reasons, including if customer service issues are not satisfactorily resolved, a desire to reduce discretionary spending, or a perception that they do not use the service sufficiently, that the solution is a poor value, or that competitive services provide a better value or experience. If our customer retention rate decreases, we may need to increase the rate at which we add new customers in order to maintain and grow our revenue, which may require us to incur significantly higher advertising and marketing expenses than we currently anticipate, or our revenue may decline. A significant decrease in our customer retention rate would therefore have an adverse effect on our business, financial condition, and operating results.

***Our relationships with our partners may be terminated or may not continue to be beneficial in generating new customers, which could adversely affect our ability to increase our customer base.***

We maintain a network of active partners, which refer customers to us through links on their websites and outbound promotion to their customers. If we are unable to maintain our contractual relationships with existing partners or establish new contractual relationships with potential partners, we may experience delays and increased costs in adding customers, which could have a material adverse effect on us. The number of customers that we are able to add through these relationships is dependent on the marketing efforts of our partners, over which we have very little control.

***We have recently introduced additional solutions for mobile devices and, if users of these devices do not widely adopt our solutions, our revenue and operating results could be adversely affected.***

The number of people who access the internet through devices other than personal computers, including smartphones and handheld tablets or computers, has increased dramatically in the past few years and is projected to continue to increase. In addition, people are increasingly using their mobile devices to create and store data and other content that is important to them. We recently introduced our mobile backup solutions for the iPhone and Android smartphones; however, these solutions have not yet achieved widespread adoption. If one or more of our competitors were to launch similar services, or if we are unsuccessful in achieving widespread adoption of our mobile solutions, our competitive position could be materially harmed. As new devices and new platforms are continually being released, it is difficult to predict the problems that we may encounter in developing versions of our solutions for use on these mobile devices, and we may need to devote significant resources to the creation, support, and maintenance of such solutions, which could adversely affect our operating results.

***If we are unable to expand our base of SMB customers, our business could be adversely affected.***

In 2010, we introduced the first version of our backup solution targeted toward SMBs, which are generally companies that are too small to have a dedicated in-house IT staff. We have committed and continue to commit

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**Table of Contents**

substantial resources to the expansion and increased marketing of our SMB offerings. If we are unable to market and sell our solutions to SMBs with competitive pricing and in a cost-effective manner, our ability to grow our revenue and achieve profitability will be harmed. We believe that it is more difficult and expensive to attract and retain SMB customers than consumers, because SMBs:

are difficult to reach without using more expensive, targeted sales campaigns;

may have different or much more complex needs than those of individual consumers, such as archiving, version control, enhanced security requirements, and other forms of encryption and authentication, which our solutions may not adequately address; and

frequently cease operations due to the sale or failure of their business.

In addition, SMBs frequently have limited budgets and are more likely to be significantly affected by economic downturns than larger, more established companies. As a result, they may choose to spend funds on items other than our solutions, particularly during difficult economic times. If we are unsuccessful in meeting the needs of potential SMB customers, it could adversely affect our future growth and operating results.

***If we are unable to improve market recognition of and loyalty to our brand, or if our reputation were to be harmed, we could lose customers or fail to increase the number of our customers, which could harm our revenue, operating results, and financial condition.***

Given our consumer and SMB market focus, maintaining and enhancing the Carbonite brand is critical to our success. We believe that the importance of brand recognition and loyalty will increase in light of increasing competition in our markets. We plan to continue investing substantial resources to promote our brand, both domestically and internationally, but there is no guarantee that our brand development strategies will enhance the recognition of our brand. Some of our existing and potential competitors have well-established brands with greater recognition than we have. If our efforts to promote and maintain our brand are not successful, our operating results and our ability to attract and retain customers may be adversely affected. In addition, even if our brand recognition and loyalty increases, this may not result in increased use of our solutions or higher revenue.

Our offerings, as well as those of our competitors, are regularly reviewed in computer and business publications. Negative reviews, or reviews in which our competitors' products and services are rated more highly than our solutions, could negatively affect our brand and reputation. From time-to-time, our customers express dissatisfaction with our solutions, including, among other things, dissatisfaction with our customer support, our billing policies, and the way our solutions operate. If we do not handle customer complaints effectively, our brand and reputation may suffer, we may lose our customers' confidence, and they may choose not to renew their subscriptions. In addition, many of our customers participate in online blogs about computers and internet services, including our solutions, and our success depends in part on our ability to generate positive customer feedback through such online channels where consumers seek and share information. If actions that we take or changes that we make to our solutions upset these customers, their blogging could negatively affect our brand and reputation. Complaints or negative publicity about our solutions or billing practices could adversely impact our ability to attract and retain customers and our business, financial condition, and operating results.

***The termination of our relationship with any major credit card company would have a severe, negative impact on our ability to collect revenue from customers. Increases in credit card processing fees would increase our operating expenses and adversely affect our operating results.***

Substantially all of our customers purchase our solutions online with credit cards, and our business depends upon our ability to offer credit card payment options. The termination of our ability to process payments on any major credit card would significantly impair our ability to operate our business and significantly increase our administrative costs related to customer payment processing. If we fail to maintain our compliance with the data protection and documentation standards adopted by the major credit card issuers and applicable to us, these issuers could terminate their agreements with us, and we could lose our ability to offer our customers a credit

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**Table of Contents**

card payment option. If these issuers increase their credit card processing fees because we experience excessive chargebacks or refunds or for other reasons, it could adversely affect our business and operating results.

***Any significant disruption in service on our websites or in our computer systems could damage our reputation and result in a loss of customers, which would harm our business, financial condition, and operating results.***

Our brand, reputation, and ability to attract, retain and serve our customers are dependent upon the reliable performance of our websites, network infrastructure and payment systems, and our customers' ability to readily access their stored files. We have experienced interruptions in these systems in the past, including server failures that temporarily slowed down our websites' performance and our customers' ability to access their stored files, or made our websites and infrastructure inaccessible, and we may experience interruptions in the future. In addition, while we operate and maintain the primary elements of our websites and network infrastructure, some elements of this complex system are operated by third parties that we do not control and that would require significant time to replace. We expect this dependence on third parties to continue. In particular, a portion of our solution is hosted by Amazon Web Services, which provides us with computing and storage capacity pursuant to an agreement that continues until terminated by either party. Interruptions in our systems or the third-party systems on which we rely, whether due to system failures, computer viruses, physical or electronic break-ins, or other factors, could affect the security or availability of our websites and infrastructure and prevent us from being able to continuously back up our customers' data or our customers from accessing their stored data.

In addition, prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. Problems with the reliability or security of our systems could harm our reputation. Damage to our reputation and the cost of remedying these problems could negatively affect our business, financial condition, and operating results.

Our systems provide redundancy at the disk level, but do not keep separate, redundant copies of stored customer files. Instead, we rely on the fact that our customers, in effect, back up our system by maintaining the primary instance of their files. We do not intend to create redundant backup sites for our solutions. As such, a total failure of our systems, or the failure of any of our systems, could result in the loss of or a temporary inability to back up our customers' data and result in our customers being unable to access their stored files. If one of our data centers fails at the same time that our customers' computers fail, we would be unable to provide stored copies of their data. If this were to occur, our reputation could be compromised and we could be subject to liability to the customers that were affected.

Our data centers are vulnerable to damage or interruption from human error, intentional bad acts, pandemics, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures, and similar events. As the majority of our data facilities are located in a single metropolitan area, we may be more susceptible to the risk that a single event could significantly harm the operations of these facilities. The occurrence of a natural disaster, power failure or an act of terrorism, vandalism or other misconduct, a decision to close the facilities without adequate notice, or other unanticipated problems could result in lengthy interruptions in our services. The occurrence of any of the foregoing events could damage our systems and hardware or could cause them to fail completely, and our insurance may not cover such events or may be insufficient to compensate us for the potentially significant losses, including the potential harm to the future growth of our business, that may result from interruptions in our service as a result of system failures.

***We depend on data centers operated by third parties and any disruption in the operation of these facilities could adversely affect our business.***

We host our services and serve all of our customers from our network servers, which are located in data center facilities operated by third parties. While we control and have access to our servers and all of the components of our network that are located in our external data centers, we do not control the operation of these facilities. Our data center leases expire at various times in 2015 and 2016 with rights of extension, and a separate data center hosting arrangement is cancellable by us upon 120 days' notice. If we are unable to renew these

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**Table of Contents**

agreements on commercially reasonable terms, we may be required to transfer our servers to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so. During the first half of 2012, we relocated our equipment and operations from our Boston, Massachusetts data center to our other data centers and discontinued the use of our Boston, Massachusetts data center. We incurred moving and other costs in connection with this transition. See Notes 12 and 13 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information.

Problems faced by our third-party data center locations, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Our third-party data center operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data center operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data centers are unable to keep up with our growing needs for capacity, this could have an adverse effect on our business. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, or other performance problems with our services could harm our reputation and may damage our customers' stored files. Interruptions in our services might reduce our revenue, cause us to issue credits or refunds to customers, subject us to potential liability, or harm our renewal rates.

***If the security of our customers' confidential information stored in our systems is breached or their stored files are otherwise subjected to unauthorized access, our reputation and business may be harmed, and we may be exposed to liability.***

Our customers rely on our online system to store digital copies of their files, including financial records, business information, photos, and other personally meaningful content. We also store credit card information and other personal information about our customers. A breach of our network security and systems or other events that cause the loss or public disclosure of, or access by third parties to, our customers' stored files could have serious negative consequences for our business, including possible fines, penalties and damages, reduced demand for our solutions, an unwillingness of customers to provide us with their credit card or payment information, an unwillingness of our customers to use our solutions, harm to our reputation and brand, loss of our ability to accept and process customer credit card orders, and time-consuming and expensive litigation. Third parties may be able to circumvent our security by deploying viruses, worms, and other malicious software programs that are designed to attack or attempt to infiltrate our systems and networks and we may not immediately discover these attacks or attempted infiltrations. Further, outside parties may attempt to fraudulently induce our employees, consultants, or affiliates to disclose sensitive information in order to gain access to our information or our customers' information. The techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently, often are not recognized until launched against a target, and may originate from less regulated or remote areas around the world. As a result, we may be unable to proactively address these techniques or to implement adequate preventative or reactionary measures. In addition, employee or consultant error, malfeasance, or other errors in the storage, use, or transmission of personal information could result in a breach of customer or employee privacy. We maintain insurance coverage to mitigate the potential financial impact of these risks; however, our insurance may not cover all such events or may be insufficient to compensate us for the potentially significant losses, including the potential damage to the future growth of our business, that may result from the breach of customer or employee privacy.

Many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation and could cause the loss of customers. Similarly, if a well-publicized breach of data security at any other cloud backup service provider or other major consumer website were to occur, there could be a general public loss of confidence in the use of the internet for cloud backup services or commercial transactions generally. Any of these events could have material adverse effects on our business, financial condition, and operating results.

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**Table of Contents**

***We process, store and use personal information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, and our actual or perceived failure to comply with such obligations could harm our business.***

We receive, store, and process personal information and other customer data. There are numerous federal, state, local, and foreign laws regarding privacy and the storing, sharing, use, processing, disclosure and protection of personal information and other customer data, the scope of which are changing, subject to differing interpretations, and may be inconsistent among countries or conflict with other rules. We generally seek to comply with industry standards and are subject to the terms of our privacy policies and privacy-related obligations to third parties. We strive to comply with all applicable laws, policies, legal obligations, and industry codes of conduct relating to privacy and data protection to the extent possible. However, it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us to comply with our privacy policies, our privacy-related obligations to customers or other third parties, our privacy-related legal obligations, or any compromise of security that results in the unauthorized release or transfer of personally identifiable information or other customer data, may result in governmental enforcement actions, litigation, or public statements against us by consumer advocacy groups or others and could cause our customers to lose trust in us, which could have an adverse effect on our reputation and business. Our customers may also accidentally disclose their passwords or store them on a mobile device that is lost or stolen, creating the perception that our systems are not secure against third-party access. Additionally, if third parties that we work with, such as vendors or developers, violate applicable laws or our policies, such violations may also put our customers' information at risk and could in turn have an adverse effect on our business. Any significant change to applicable laws, regulations, or industry practices regarding the use or disclosure of our customers' data, or regarding the manner in which the express or implied consent of customers for the use and disclosure of such data is obtained, could require us to modify our solutions and features, possibly in a material manner, and may limit our ability to develop new services and features that make use of the data that our customers voluntarily share with us.

***We may not be able to respond to rapid technological changes with new solutions, which could have a material adverse effect on our operating results.***

The cloud backup market is characterized by rapid technological change and frequent new product and service introductions. Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing solutions, introduce new features and products, and sell into new markets. Customers may require features and capabilities that our current solutions do not have. Our failure to develop solutions that satisfy customer preferences in a timely and cost-effective manner may harm our ability to renew our subscriptions with existing customers and create or increase demand for our solutions, and may adversely impact our operating results.

The introduction of new services by competitors or the development of entirely new technologies to replace existing offerings could make our solutions obsolete or adversely affect our business and operating results. In addition, any new markets or countries into which we attempt to sell our solutions may not be receptive. We may experience difficulties with software development, design, or marketing that could delay or prevent our development, introduction, or implementation of new solutions and enhancements. We have in the past experienced delays in the planned release dates of new features and upgrades, and have discovered defects in new solutions after their introduction. There can be no assurance that new solutions or upgrades will be released according to schedule, or that when released they will not contain defects. Either of these situations could result in adverse publicity, loss of revenue, delay in market acceptance, or claims by customers brought against us, all of which could have a material adverse effect on our reputation, business, operating results, and financial condition. Moreover, upgrades and enhancements to our solutions may require substantial investment and we have no assurance that such investments will be successful. If customers do not widely adopt enhancements to our solutions, we may not be able to realize a return on our investment. If we are unable to develop, license, or acquire enhancements to our existing solutions on a timely and cost-effective basis, or if such enhancements do not achieve market acceptance, our business, operating results, and financial condition may be adversely affected.

**Table of Contents**

*Our quarterly operating results have fluctuated in the past and may continue to do so in the future. As a result, we may fail to meet or exceed the expectations of securities analysts or investors, which could cause our stock price to decline.*

Our quarterly operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly operating results or guidance fall below the expectations of securities analysts or investors, the price of our common stock could decline substantially. The following factors, among others, could cause fluctuations in our quarterly operating results or guidance:

our ability to attract new customers and retain existing customers;

our ability to accurately forecast revenue and appropriately plan our expenses;

our ability to introduce new solutions;

the actions of our competitors, including pricing changes or the introduction of new products;

our ability to effectively manage our growth;

the mix of annual and multi-year subscriptions at any given time;

seasonal variations or other cyclicalities in the demand for our solutions, including the purchasing and budgeting cycles of our SMB customers;

the timing and cost of advertising and marketing efforts;

the timing and cost of developing or acquiring technologies, services, or businesses;

the timing, operating cost, and capital expenditures related to the operation, maintenance, and expansion of our business;

service outages or security breaches and any related impact on our reputation;

our ability to successfully manage any future acquisitions of businesses, solutions, or technologies;

the impact of worldwide economic, industry, and market conditions and those conditions specific to internet usage and online businesses;

costs associated with defending intellectual property infringement and other claims; and



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changes in government regulation affecting our business.

We believe that our quarterly revenue and operating results may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful. You should not rely on the results of one quarter as an indication of future performance.

Seasonal variations in our business may also cause fluctuations in our financial results. For example, we generally spend more on advertising during the first and third quarters of each year to capitalize on lower advertising rates in these periods and increased sales of devices that create or store data during post-holiday and back to school periods and our bookings tend to be higher in these periods. While we believe that 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. We believe that our business may become more seasonal in the future as our growth rate slows, and that such seasonal variations in advertising expenditures and customer purchasing patterns may result in fluctuations in our financial results.

***Growth may place significant demands on our management and our infrastructure.***

We have experienced substantial growth in our business. This growth has placed and may continue to place significant demands on our management and our operational and financial infrastructure. As our operations grow in size, scope, and complexity, we will need to improve and upgrade our systems and infrastructure to attract,

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## **Table of Contents**

service, and retain an increasing number of customers. The expansion of our systems and infrastructure will require us to commit substantial financial, operational, and technical resources in advance of an increase in the volume of business, with no assurance that the volume of business will increase. Any such additional capital investments will increase our cost base. Continued growth could also strain our ability to maintain reliable service levels for our customers, develop and improve our operational, financial, and management controls, enhance our reporting systems and procedures, and recruit, train, and retain highly skilled personnel. If we fail to achieve the necessary level of efficiency in our organization as we grow, our business, financial condition, and operating results could be harmed.

***We may expand by acquiring or investing in other companies, which may divert our management's attention, result in additional dilution to our stockholders, and consume resources that are necessary to sustain our business.***

We may in the future acquire complementary products, services, technologies, or businesses. We may also enter into relationships with other businesses to expand our portfolio of solutions or our ability to provide our solutions in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing, or investments in other companies. We do not have substantial experience with integrating and managing acquired businesses or assets. Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to complete these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close.

Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for the development of our business. Moreover, the anticipated benefits of any acquisition, investment, or business relationship may not be realized or we may be exposed to unknown liabilities, including litigation against the companies that we may acquire. In connection with any such transaction, we may:

issue additional equity securities that would dilute our stockholders;

use cash that we may need in the future to operate our business;

incur debt on terms unfavorable to us, that we are unable to repay, or that may place burdensome restrictions on our operations;

incur large charges or substantial liabilities; or

become subject to adverse tax consequences or substantial depreciation, deferred compensation, or other acquisition-related accounting charges.

Any of these risks could harm our business and operating results.

***Integration of an acquired company's operations may present challenges.***

The integration of an acquired company requires, among other things, coordination of administrative, sales and marketing, accounting and finance functions, and expansion of information and management systems. Integration may prove to be difficult due to the necessity of coordinating geographically separate organizations and integrating personnel with disparate business backgrounds and accustomed to different corporate cultures. We may not be able to retain key employees of an acquired company. Additionally, the process of integrating a new product or service may require a disproportionate amount of time and attention of our management and financial and other resources. Any difficulties or problems encountered in the integration of a new product or service could have a material adverse effect on our business.

The integration of an acquired company may cost more than we anticipate, and it is possible that we will incur significant additional unforeseen costs in connection with such integration, which may negatively impact our earnings.



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## **Table of Contents**

In addition, we may only be able to conduct limited due diligence on an acquired company's operations. Following an acquisition, we may be subject to unforeseen liabilities arising from an acquired company's past or present operations and these liabilities may be greater than the warranty and indemnity limitations that we negotiate. Any unforeseen liability that is greater than these warranty and indemnity limitations could have a negative impact on our financial condition.

Even if successfully integrated, there can be no assurance that our operating performance after an acquisition will be successful or will fulfill management's objectives.

***The loss of one or more of our key personnel, or our failure to attract, integrate, and retain other highly qualified personnel, could harm our business.***

We depend on the continued service and performance of our key personnel. We do not have long-term employment agreements with any of our officers or key employees. In addition, many of our key technologies and systems are custom-made for our business by our personnel. The loss of key personnel, including key members of our management team, as well as certain of our key marketing, sales, product development, or technology personnel, could disrupt our operations and have an adverse effect on our ability to grow our business. In addition, several of our key personnel have only recently been employed by us, and we are still in the process of integrating these personnel into our operations. Our failure to successfully integrate these key employees into our business could adversely affect our business.

To execute our growth plan, we must attract and retain highly qualified personnel. Competition for these employees is intense, and we may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. New hires require significant training and, in most cases, take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, in making employment decisions, particularly in the internet and high-technology industries, job candidates often consider the value of the stock options that they are to receive in connection with their employment. In addition, employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we fail to attract new personnel, or fail to retain and motivate our current personnel, our business and growth prospects could be severely harmed.

***Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity, and teamwork fostered by our culture, and our business may be harmed.***

We believe that our corporate culture has been a key contributor to our success. If we do not continue to develop our corporate culture as we grow and evolve, including maintaining our culture of transparency with our employees, it could harm our ability to foster the innovation, creativity, and teamwork that we believe that we need to support our growth. As our organization grows and we are required to implement more complex organizational structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture, which could negatively impact our future success. In addition, the availability of a public market for our securities could create disparities of wealth among our employees, which could adversely impact relations among employees and our corporate culture in general.

***Our operating results may be harmed if we are required to collect sales or other related taxes for our subscription services in jurisdictions where we have not historically done so.***

We do not believe that we are required to collect sales, use, or other similar taxes from our customers. However, one or more states or countries may seek to impose sales, use, or other tax collection obligations on us,

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**Table of Contents**

including for past sales by us or our resellers and other partners. A successful assertion by a state, country, or other jurisdiction that we should have or should be collecting sales, use, or other taxes on our services could, among other things, result in substantial tax liabilities for past sales, create significant administrative burdens for us, discourage customers from purchasing our services, or otherwise harm our business and operating results.

***Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.***

As of December 31, 2012, we had federal, state, and foreign net operating loss carryforwards, or NOLs, of \$116.9 million, \$107.0 million, and \$2.0 million, respectively, available to offset future taxable income, which expire in various years through 2033 if not utilized. A lack of future taxable income would adversely affect our ability to utilize these NOLs before they expire. Under the provisions of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, substantial changes in our ownership may limit the amount of pre-change NOLs that can be utilized annually in the future to offset taxable income. Section 382 of the Internal Revenue Code, or Section 382, imposes limitations on a company's ability to use NOLs if a company experiences a more-than-50-percent ownership change over a three-year testing period. We performed an analysis of our changes in ownership through December 31, 2012 and have adjusted our NOLs as of that date to reflect the usage limitations, calculated in accordance with Section 382, resulting from such changes in ownership. If additional changes in our ownership occur in the future, our ability to use NOLs may be further limited. For these reasons, we may not be able to utilize a material portion of the NOLs, even if we achieve profitability. If we are limited in our ability to use our NOLs in future years in which we have taxable income, we will pay more taxes than if we were able to fully utilize our NOLs. This could adversely affect our operating results and the market price of our common stock.

***Any expenses or liability resulting from litigation could adversely affect our operating results and financial condition.***

From time to time, we may be subject to claims or litigation, including intellectual property litigation as described elsewhere in this Annual Report on Form 10-K. Any such claims or litigation may be time-consuming and costly, divert management resources, require us to change our services, require us to credit or refund subscription fees, or have other adverse effects on our business. Any of the foregoing could have a material adverse effect on our operating results and could require us to pay significant monetary damages. In addition, we receive and must respond on a periodic basis to subpoenas from law enforcement agencies seeking information in connection with criminal investigations. While we have in place a procedure to respond to such subpoenas, any failure on our part to properly respond to such subpoena requests could expose us to litigation or other proceedings and adversely affect our business, financial condition, and operating results.

***Our success depends on our customers' continued high-speed access to the internet and the continued reliability of the internet infrastructure.***

Our business depends on our customers' high-speed access to the internet, as well as the continued maintenance and development of the internet infrastructure. The future delivery of our solutions will depend on third-party internet service providers to expand high-speed internet access, to maintain a reliable network with the necessary speed, data capacity and security, and to develop complementary products and services, including high-speed modems, for providing reliable and timely internet access and services. All of these factors are out of our control. To the extent that the internet continues to experience an increased number of users, frequency of use, or bandwidth requirements, the internet may become congested and be unable to support the demands placed on it, and its performance or reliability may decline. Any internet outages or delays could adversely affect our ability to provide services to our customers.

***Our business may be significantly impacted by a change in the economy, including any resulting effect on consumer spending.***

Our business may be affected by changes in the economy generally, including any resulting effect on consumer spending. Our solutions are discretionary purchases, and our customers may reduce their discretionary

## **Table of Contents**

spending on our solutions during an economic downturn. Although we have not experienced a material reduction in subscription renewals, we may experience such a reduction in the future, especially in the event of a prolonged recessionary period. Conversely, media prices may increase in a period of economic growth, which could significantly increase our marketing and advertising expenses. As a result, our business, financial condition, and operating results may be significantly affected by changes in the economy generally.

***We face many risks associated with our plans to expand internationally, which could harm our business, financial condition, and operating results.***

We anticipate that our efforts to expand internationally will entail the marketing and advertising of our services and brand and the development of localized websites. We do not have substantial experience in selling our solutions in international markets or in conforming to the local cultures, standards, or policies necessary to successfully compete in those markets, and we must invest significant resources in order to do so. We may not succeed in these efforts or achieve our customer acquisition or other goals. For some international markets, customer preferences and buying behaviors may be different, and we may use business or pricing models that are different from our traditional subscription model to provide cloud backup and related services to customers. Our revenue from new foreign markets may not exceed the costs of establishing, marketing, and maintaining our international offerings, and therefore may not be profitable on a sustained basis, if at all.

In addition, conducting international operations subjects us to new risks that we have not generally faced in the U.S. These risks include:

localization of our solutions, including translation into foreign languages and adaptation for local practices and regulatory requirements;

lack of experience in other geographic markets;

strong local competitors;

cost and burden of complying with, lack of familiarity with, and unexpected changes in foreign legal and regulatory requirements, including consumer and data privacy laws;

difficulties in managing and staffing international operations;

fluctuations in currency exchange rates or restrictions on foreign currency;

potentially adverse tax consequences, including the complexities of transfer pricing, foreign value added or other tax systems, double taxation and restrictions, and/or taxes on the repatriation of earnings;

dependence on third parties, including channel partners with whom we do not have extensive experience;

compliance with the Foreign Corrupt Practices Act, economic sanction laws and regulations, export controls, and other U.S. laws and regulations regarding international business operations;

increased financial accounting and reporting burdens and complexities;

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political, social, and economic instability abroad, terrorist attacks, and security concerns in general; and

reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

Our software contains encryption technologies, certain types of which are subject to U.S. and foreign export control regulations and, in some foreign countries, restrictions on importation and/or use. Any failure on our part

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**Table of Contents**

to comply with encryption or other applicable export control requirements could result in financial penalties or other sanctions under the U.S. export regulations, including restrictions on future export activities, which could harm our business and operating results. Regulatory restrictions could impair our access to technologies that we seek for improving our solutions and may also limit or reduce the demand for our solutions outside of the U.S.

***We may not be able to maintain control of our business in China.***

The government of the People's Republic of China, or PRC, restricts foreign investment in internet and online advertising businesses. Accordingly, we operate our cloud backup business in China through an affiliated entity in China owned by an individual designated by us who is a PRC citizen. We have entered into contractual arrangements with our affiliated entity and its individual stockholder that are intended to protect our technologies and business. We have loaned funds to the designated individual in order to enable the individual to form the affiliated entity and obtain any necessary licenses, including an Internet Content Provider (ICP) license, which was granted by the PRC government, and we may continue to loan funds to the designated individual in the future. All loans are, and will continue to be, secured by the capital stock of the affiliated entity and the designated individual stockholder has granted us the contractual right to exercise his rights as the sole stockholder of the affiliated entity.

We cannot assure you, however, that we will be able to enforce these contracts. We have no equity ownership interest in the affiliated entity and we rely on contractual arrangements with the entity and the designated individual stockholder to control and operate the entity. These contractual arrangements may not be as effective in providing control over the affiliated entity as direct ownership. For example, the entity could fail to take actions required for, or beneficial to, our business or fail to maintain our websites despite its contractual obligations to do so. In addition, we cannot assure you that the individual shareholder of the affiliated entity will always act in our best interests. If the individual stockholder of our affiliated entity fails to perform his obligations under the respective agreements with us, we may need to engage in litigation in China to enforce our rights, which may be time-consuming and costly, divert management resources, or have other adverse effects on our business, and we may not be successful in enforcing our rights.

***Enforcing agreements and laws in China is difficult and may be impossible because China does not have a comprehensive system of laws.***

In China, enforcement of contractual agreements may be sporadic, and implementation and interpretation of laws may be inconsistent. The PRC judiciary is relatively inexperienced in interpreting agreements and enforcing China's laws, leading to a higher than usual degree of uncertainty as to the outcome of any litigation. Even where adequate law exists in China, it may not be possible to obtain swift and equitable enforcement of such law, or to obtain enforcement of a judgment or an arbitration award by a court of another jurisdiction. The PRC government has exercised and continues to exercise substantial control over virtually every aspect of the Chinese economy through regulation and state ownership. Many of the current reforms that support private business in China are of recent origin or are provisional in nature. Other political, economic and social factors, such as political changes, changes in the rates of economic growth, unemployment, or inflation, or in the disparities of per capita wealth among citizens of China and between regions within China, could also lead to further readjustment of the PRC government's reform measures. It is not possible to predict whether the PRC government will continue to be as supportive of private business in China, nor is it possible to predict how any future reforms will affect our business.

Specifically, the laws and regulations governing our business or the enforcement and performance of our proposed contractual arrangements with our affiliated Chinese entity and the designated individual stockholder are relatively new and may be subject to change, and their official interpretation and enforcement may involve substantial uncertainty. New laws and regulations that affect our business may also be applied retroactively. We cannot assure you that the PRC government would agree that the operating arrangements of our affiliated Chinese entity comply with PRC licensing, registration, or other regulatory requirements, with existing policies, or with requirements or policies that may be adopted in the future. For example, in September 2011, the PRC



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## **Table of Contents**

Ministry of Commerce stated that the relevant departments of the PRC government are jointly considering additional regulation of the type of investment structure that we use, which is based on the approach used by other non-PRC companies with respect to their conduct of businesses that require an ICP license. If the PRC government determines that we do not comply with applicable law, it could revoke our business and operating licenses and those of our affiliated Chinese entity, including our affiliated entity's ICP license, require us to restructure our operations, require us to discontinue or restrict our operations, restrict our right to collect revenue, block our websites, impose additional conditions or requirements with which we may not be able to comply, impose restrictions on our business operations or on our customers, or take other regulatory or enforcement actions against us that could be harmful to our business.

In addition, because of the particular weakness of the Chinese intellectual property regime, it is often difficult to create and enforce intellectual property rights in China. Accordingly, we may not be able to effectively protect our intellectual property rights in China against infringement by other business entities, individuals, and current or former employees.

### **Risks Related to Intellectual Property**

***Assertions by a third party that our solutions infringe its intellectual property, whether or not correct, could subject us to costly and time-consuming litigation or expensive licenses. We are currently a defendant in a lawsuit alleging patent infringement.***

There is frequent litigation in the software and technology industries based on allegations of infringement or other violations of intellectual property rights. Many companies are devoting significant resources to obtaining patents that could affect many aspects of our business. Third parties may claim that our technologies or solutions infringe or otherwise violate their patents or other intellectual property rights. As we face increasing competition and become increasingly visible as a publicly-traded company, or if we become more successful, the possibility of new third-party claims may increase.

We have licensed proprietary technologies from third parties that we use in our technologies and business, and we cannot be certain that the owners' rights in their technologies will not be challenged, invalidated, or circumvented. If we are forced to defend ourselves against intellectual property infringement claims, whether they have merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel, limitations on our ability to use our current websites and technologies, and an inability to market or provide our solutions. As a result of any such claim, we may have to develop or acquire non-infringing technologies, pay damages, enter into royalty or licensing agreements, cease providing certain services, adjust our marketing and advertising activities, or take other actions to resolve the claims. These actions, if required, may be costly or unavailable on terms acceptable to us, or at all.

Furthermore, we may acquire proprietary technologies from third parties and may incorporate such technologies in our solutions. In addition to the general risks described above associated with intellectual property and other proprietary rights, we are subject to the additional risk that the seller of such technologies may not have appropriately created, maintained, or enforced their rights in such technology.

In August 2010, Oasis Research, LLC, or Oasis Research, filed a lawsuit against us and several of our competitors and other online technology companies in the U.S. District Court for the Eastern District of Texas, alleging that our cloud backup storage services and other companies' products or services infringe certain of Oasis Research's patents. Oasis Research seeks an award for damages in an unspecified amount. Oasis Research does not currently seek an injunction. A trial date has been set for March 14, 2013. We are not able to assess with certainty the outcome of this lawsuit or the amount or range of potential damages or future payments associated with this lawsuit at this time. However, any litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending this lawsuit or its resolution will not have a material adverse impact on our business, operations, financial condition, or cash flows.

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**Table of Contents**

***Our success depends in large part on our ability to protect and enforce our intellectual property rights. If we are not able to adequately protect our intellectual property and proprietary technologies to prevent use or appropriation by our competitors, the value of our brand and other intangible assets may be diminished, and our business may be adversely affected.***

Our future success and competitive position depend in large part on our ability to protect our intellectual property and proprietary technologies. We rely on a combination of trademark, patent, copyright, and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection and may not now or in the future provide us with a competitive advantage. CARBONITE is a registered trademark in the U.S. and in over 30 other countries, including countries in the European Union. Carbonite also has additional registrations and pending applications for additional marks in the U.S. and other countries, including but not limited to Carbonite The Better Backup Plan, Green Dot Logo, Back it up. Get it back, Because Your Life is On Your Computer, Carbonite and the Green Dot Logo, Carbonite Lock Logo and Chinese character representations for Carbonite. We cannot assure you that any future trademark registrations will be issued for pending or future applications or that any registered trademarks will be enforceable or provide adequate protection of our proprietary rights. We currently have four issued patents and 18 pending patent applications in the U.S. and internationally. We cannot assure you that any patents will issue from any such patent applications, that patents that issue from such applications will give us the protection that we seek, or that any such patents will not be challenged, invalidated, or circumvented. Any patents that may issue in the future from our pending or future patent applications may not provide sufficiently broad protection and may not be enforceable in actions against alleged infringers.

There can be no assurance that the steps that we take will be adequate to protect our technologies and intellectual property, that our trademark and patent applications will lead to registered trademarks or issued patents, that others will not develop or patent similar or superior technologies, products, or services, or that our trademarks, patents, and other intellectual property will not be challenged, invalidated, or circumvented by others. Furthermore, effective trademark, patent, copyright, and trade secret protection may not be available in every country in which our services are available or where we have employees or independent contractors. In addition, the legal standards relating to the validity, enforceability, and scope of protection of intellectual property rights in internet-related industries are uncertain and still evolving.

***We may be involved in lawsuits to protect or enforce our patents, which could be expensive and time consuming and could materially harm our business.***

The steps we have taken may not adequately protect our intellectual property or prevent unauthorized use of our technologies. Others may independently develop technologies that are competitive to ours or infringe our intellectual property. To counter infringement or unauthorized use, we may be required to file patent infringement claims, which can be expensive and time-consuming to litigate. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop others from using the technology at issue on the grounds that our patent(s) do not cover such technology. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not being issued. If our efforts to protect our technologies and intellectual property are inadequate, the value of our brand and other intangible assets may be diminished and competitors may be able to mimic our solutions and methods of operations. Any of these events could have a material adverse effect on our business, financial condition, and operating results.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure. In addition, during the course of any such litigation, there could be public announcements of the results of hearings, motions, or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock.

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## **Table of Contents**

***Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and proprietary information. Failure to protect our proprietary information could make it easier for third parties to compete with our solutions and harm our business.***

We have devoted substantial resources to the development of our proprietary technologies and related processes. In order to protect our proprietary technologies and processes, we rely in part on trade secret laws and confidentiality agreements with our employees, licensees, independent contractors, and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover our trade secrets, in which case we would not be able to assert trade secret rights, or develop similar technologies and processes. Further, laws in certain jurisdictions may afford little or no trade secret protection, and any changes in, or unexpected interpretations of, the intellectual property laws in any country in which we operate may compromise our ability to enforce our intellectual property rights. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure or inability to obtain or maintain trade secret protection or otherwise protect our proprietary rights could adversely affect our business.

***Our use of open source software could negatively affect our ability to sell our solutions and subject us to possible litigation.***

A portion of the technologies licensed by us to our customers incorporates so-called open source software, and we may incorporate open source software in the future. Such open source software is generally licensed by its authors or other third parties under open source licenses. These licenses may subject us to certain unfavorable conditions, including requirements that we offer our solutions that incorporate the open source software for no cost, that we make publicly available source code for modifications or derivative works we create based upon, incorporating, or using the open source software, and/or that we license such modifications or derivative works under the terms of the particular open source license. Additionally, if a third-party software provider has incorporated open source software into software that we license from such provider, we could be required to disclose any of our source code that incorporates or is a modification of such licensed software. If an author or other third party that distributes open source software that we use or license were to allege that we had not complied with the conditions of the applicable license, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our solutions that contained the open source software, and required to comply with the foregoing conditions. Any of the foregoing could disrupt the distribution and sale of our solutions and harm our business.

***We rely on third-party software, including server software and licenses from third parties to use patented intellectual property, that is required to develop and provide our solutions.***

We rely on software licensed from third parties to develop and offer our solutions, including server software from Microsoft and other patented third-party technologies. In addition, we may need to obtain future licenses from third parties to use intellectual property associated with the development of our solutions, which might not be available to us on acceptable terms, or at all. Any loss of the right to use any software required for the development and maintenance of our solutions could result in delays in the provision of our solutions until equivalent technology is either developed by us, or, if available from others, is identified, obtained, and integrated, which delay could harm our business. Any errors or defects in third-party software could result in errors or a failure of our solutions, which could harm our business.

***If we are unable to protect our domain names, our reputation, brand, customer base, and revenue, as well as our business and operating results, could be adversely affected.***

We have registered domain names for websites, or URLs, that we use in our business, such as [www.carbonite.com](http://www.carbonite.com). If we are unable to maintain our rights in these domain names, our competitors or other third parties could capitalize on our brand recognition by using these domain names for their own benefit. In

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## **Table of Contents**

addition, although we own the Carbonite domain name under various global top level domains such as .com and .net, as well as under various country-specific domains, we might not be able to, or may choose not to, acquire or maintain other country-specific versions of the Carbonite domain name or other potentially similar URLs. Domain names similar to ours have already been registered in the U.S. and elsewhere, and our competitors or other third parties could capitalize on our brand recognition by using domain names similar to ours. The regulation of domain names in the U.S. and elsewhere is generally conducted by internet regulatory bodies and is subject to change. If we lose the ability to use a domain name in a particular country, we may be forced to either incur significant additional expenses to market our solutions within that country, including the development of a new brand and the creation of new promotional materials, or elect not to sell our solutions in that country. Either result could substantially harm our business and operating results. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars, or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize the name Carbonite in all of the countries in which we currently conduct or intend to conduct business. Further, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights varies among jurisdictions and is unclear in some jurisdictions. We may be unable to prevent third parties from acquiring and using domain names that infringe, are similar to, or otherwise decrease the value of, our brand or our trademarks. Protecting and enforcing our rights in our domain names and determining the rights of others may require litigation, which could result in substantial costs, divert management attention, and not be decided favorably to us.

***Material defects or errors in our software could harm our reputation, result in significant costs to us, and impair our ability to sell our solutions.***

The software applications underlying our solutions are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects or errors in our solutions, and new defects or errors in our existing solutions may be detected in the future by us or our customers. The costs incurred in correcting such defects or errors may be substantial and could harm our operating results. In addition, we rely on hardware purchased or leased and software licensed from third parties to offer our solutions. Any defects in, or unavailability of, our or third-party software or hardware that cause interruptions to the availability of our solutions could, among other things:

cause a reduction in revenue or delay in market acceptance of our solutions;

require us to issue credits or refunds to our customers or expose us to claims for damages;

cause us to lose existing customers and make it more difficult to attract new customers;

divert our development resources or require us to make extensive changes to our solutions or software, which would increase our expenses;

increase our technical support costs; and

harm our reputation and brand.

### **Risks Related to Ownership of our Common Stock**

***Our stock price may be volatile due to fluctuations in our operating results and other factors, each of which could cause our stock price to decline.***

Shares of our common stock were sold in our initial public offering in August 2011 at a price of \$10.00 per share, and our common stock has subsequently traded as high as \$21.10 and as low as \$5.75. An active, liquid, and orderly market for our common stock may not be developed or sustained, which could depress the trading price of our common stock. The market price for shares of our common stock could be subject to significant



**Table of Contents**

fluctuations in response to various factors, some of which are beyond our control. Some of the factors that may cause the market price for shares of our common stock to fluctuate include:

fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;

actual or anticipated fluctuations in our key operating metrics, financial condition, and operating results;

loss of existing customers or inability to attract new customers;

actual or anticipated changes in our growth rate;

announcements of technological innovations or new offerings by us or our competitors;

our announcement of actual results for a fiscal period that are lower than projected or expected or our announcement of revenue or earnings guidance that is lower than expected;

changes in estimates of our financial results or recommendations by securities analysts;

failure of any of our solutions to achieve or maintain market acceptance;

changes in market valuations of similar companies;

success of competitive products or services;

changes in our capital structure, such as future issuances of securities or the incurrence of debt;

announcements by us or our competitors of significant products or services, contracts, acquisitions, or strategic alliances;

regulatory developments in the U.S. or foreign countries;

actual or threatened litigation involving us or our industry;

additions or departures of key personnel;

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general perception of the future of the cloud backup market or our solutions;

share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;

sales of our shares of common stock by our existing stockholders; and

changes in general economic, industry, and market conditions.

In addition, the stock market in general, and the market for internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. This litigation, if instituted against us, could result in very substantial costs, divert our management's attention and resources, and harm our business, financial condition, and operating results. In addition, recent fluctuations in the financial and capital markets have resulted in volatility in securities prices.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business, and investors' views of us.***

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. As part of our process of documenting and testing our internal control over financial reporting, we may identify areas for further attention and improvement. Implementing any appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing

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## **Table of Contents**

processes, and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors' perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our solutions to new and existing customers.

***Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our business could reduce our ability to compete successfully.***

Although we currently anticipate that our available funds, including the net proceeds of our initial public offering and our available bank line of credit, will be sufficient to meet our cash needs for at least the next 12 months, we may require additional financing in the future. Our ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets at the time we seek financing. If we need to raise additional funds, we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per share value of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

develop or enhance our solutions;

continue to expand our development, sales, and marketing organizations;

acquire complementary technologies, products, or businesses;

expand our operations in the U.S. or internationally;

hire, train, and retain employees;

respond to competitive pressures or unanticipated working capital requirements; or

continue our operations.

***Future sales of shares of our common stock by existing stockholders could depress the market price of our common stock.***

If our existing stockholders sell, or indicate an intent to sell, a substantial number of shares of our common stock in the public market, the trading price of our common stock could decline significantly. A large portion of our outstanding shares of common stock is held by our directors, executive officers, and holders of more than 5% of our common stock, or their respective affiliates. Two of our largest shareholders are venture capital funds, which are typically structured to have a finite life. As these venture capital funds approach or pass the respective terms of their funds, their decision to sell or hold our common stock may be based not only on the underlying investment merits of our securities but also on the requirements of their internal fund structure. Additionally, our directors, executive officers, and holders of more than 5% of our common stock, and their respective affiliates beneficially own approximately 18.5 million shares of our common stock, which represents 69% of our issued and outstanding shares of common stock as of December 31, 2012. If these shares are sold, or if it is perceived that they will be sold in the public market, the trading price of our common stock could decline substantially.

***Our directors, executive officers, and principal stockholders have substantial control over us and could delay or prevent a change in corporate control.***



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Our directors, executive officers, and holders of more than 5% of our common stock, together with their affiliates, beneficially hold a majority of our outstanding shares of common stock and have the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any

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## **Table of Contents**

merger, consolidation, or sale of all or substantially all of our assets. In addition, these stockholders, acting together, have the ability to control or influence the management and affairs of our company. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a change in control of our company.

***If securities or industry analysts do not publish or cease publishing research or reports about us, our business, or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market, or our competitors. If any of the analysts who cover us change their recommendation regarding our securities adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who covers us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***Our management will continue to have broad discretion over the use of the proceeds we received in our initial public offering and might not apply the proceeds in ways that increase the value of your investment.***

Our management will continue to have broad discretion to use our net proceeds from our initial public offering, and you will be relying on the judgment of our management regarding the application of these proceeds. Our management might not apply these proceeds in ways that increase the value of your investment. We intend to use the remaining net proceeds from our initial public offering primarily for general corporate purposes, including working capital, sales and marketing activities, general and administrative matters, and capital expenditures. We may also use a portion of these proceeds to acquire, invest in, or obtain rights to complementary technologies, solutions, or businesses. Until we use these proceeds from our initial public offering, we plan to invest them, and these investments may not yield a favorable rate of return. If we do not invest or apply the remaining net proceeds from our initial public offering in ways that enhance stockholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

***We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.***

We have never declared or paid any cash dividends on our common stock and do not intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth and continuing operations. In addition, the provisions of our revolving credit facility prohibit us from paying cash dividends. Therefore, you are not likely to receive any dividends on your shares of common stock for the foreseeable future and the success of an investment in shares of our common stock will depend upon any future appreciation in their value. Our common stock may not appreciate in value or even maintain the price at which our stockholders have purchased their shares.

***Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.***

Our certificate of incorporation and bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;

no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

**Table of Contents**

the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death, or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer, or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action;

limiting the liability of, and providing indemnification to, our directors and officers;

controlling the procedures for the conduct and scheduling of stockholder meetings;

providing the board of directors with the express power to postpone previously scheduled annual meetings of stockholders and to cancel previously scheduled special meetings of stockholders;

providing that directors may be removed prior to the expiration of their terms by stockholders only for cause; and

advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our principal executive offices are located in Boston, Massachusetts, in a 39,775 square-foot facility, under a lease expiring on December 31, 2016. We also have a 22,592 square foot customer support facility in Lewiston, Maine under a lease expiring on June 1, 2016. We maintain

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small offices in Princeton, New Jersey and Sunnyvale, California, as well as a small development office in Beijing, China.

Our data centers are located at two facilities in Massachusetts and one facility in Arizona. Our Wakefield, Massachusetts and Phoenix, Arizona data center leases expire between September 2015 and January 2016 and our Somerville, Massachusetts separate data hosting arrangement is cancellable by us upon 120 days notice.

**Table of Contents**

**ITEM 3. LEGAL PROCEEDINGS**

In August 2010, Oasis Research, LLC, or Oasis Research, filed a lawsuit against us and several of our competitors and other online technology companies in the U.S. District Court for the Eastern District of Texas, alleging that our cloud backup storage services, and the other companies products or services, infringe certain of Oasis Research's patents. Oasis Research seeks an award for damages in an unspecified amount. Oasis Research does not currently seek an injunction. A trial date has been set for March 14, 2013. We are not able to assess with certainty the outcome of this lawsuit or the amount or range of potential damages or future payments associated with this lawsuit at this time.

In May 2012, Markley Boston, LLC filed a lawsuit against us in Massachusetts Superior Court seeking \$1.6 million in damages related to our termination of a data center lease. We have accrued \$1.0 million, being the discounted present value of the remaining contractual payments under the lease agreement. In addition, as a result of a court order, we have presented \$0.5 million as restricted cash on our balance sheet. See Notes 12 and 13 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information.

While we are not able to assess with certainty the outcome of these lawsuits, we intend to defend ourselves and prosecute our counterclaims vigorously. However, any litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending these lawsuits or their resolution will not have a material adverse impact on our business, operations, financial condition, or cash flows. In addition to these lawsuits, from time to time, we have been and may become involved in legal proceedings arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, we are not presently involved in any other legal proceeding in which the outcome, if determined adversely to us, would be expected to have a material adverse effect on our business, operating results, or financial condition. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock has been traded on The NASDAQ Global Market under the symbol CARB since our initial public offering on August 11, 2011. Prior to this time, there was no public market for our common stock. The following table shows the high and low sale prices per share of our common stock as reported on The NASDAQ Global Market for the periods indicated:

	2012		2011	
	High	Low	High	Low
First Quarter	\$ 11.69	\$ 7.90	\$	\$
Second Quarter	\$ 11.70	\$ 6.74	\$	\$
Third Quarter	\$ 10.14	\$ 5.78	\$ 21.10	\$ 10.80
Fourth Quarter	\$ 10.12	\$ 5.75	\$ 14.65	\$ 10.62

On March 1, 2013, the closing price as reported on The NASDAQ Global Market, of our common stock was \$9.77 per share. As of March 1, 2013, we had approximately 60 holders of record of our common stock. This does not include the number of persons whose stock is held in nominee or street name accounts through brokers.

We have never declared or paid, and do not anticipate declaring or paying, any cash dividends on our common stock. Any future determination as to the declaration and payment of dividends, will be at the discretion of our board of directors and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, and other factors that our board of directors may deem relevant.

Our equity plan information required by this item is incorporated by reference to the information in Part III, Item 12 of this Annual Report on Form 10-K.

**Performance Graph**

The following performance graph compares the cumulative total return to holders of our common stock for the period from August 11, 2011, the date our common stock commenced trading on The NASDAQ Global Market, through December 31, 2012, against the cumulative total return of The NASDAQ Composite Index and The NASDAQ-100 Technology Sector Index.

The comparison assumes that \$100.00 was invested in our common stock, The NASDAQ Composite Index and The NASDAQ-100 Technology Sector Index, and assumes reinvestment of dividends, if any. The graph assumes the initial value of our common stock on August 11, 2011 was the closing sale price on that day of \$12.35 per share and not the initial offering price to the public of \$10.00 per share. The performance shown on the graph below is based on historical results and is not intended to suggest future performance.

**Table of Contents**

**COMPARISON OF CUMULATIVE TOTAL RETURN  
AMONG CARBONITE, INC., THE NASDAQ COMPOSITE INDEX  
AND THE NASDAQ-100 TECHNOLOGY SECTOR INDEX**

*This performance graph shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Carbonite, Inc. under the Securities Act of 1933, as amended.*

**Recent Sales of Unregistered Securities**

There were no unregistered sales of our equity securities during the twelve months ended December 31, 2012.

**Use of Proceeds**

On August 10, 2011, our registration statement on Form S-1 (File No. 333-174139) was declared effective for our initial public offering. On August 16, 2011, we closed our initial public offering of 7,187,500 shares of common stock at an offering price of \$10.00 per share, of which 6,303,973 shares were sold by us, including 937,500 shares pursuant to the underwriters' option to purchase additional shares, and 883,527 shares were sold by selling stockholders. The underwriters of the offering were Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, William Blair & Company, L.L.C., Canaccord Genuity Inc., Oppenheimer & Co. Inc., and Pacific Crest Securities Inc. Following the sale of the shares in connection with the closing of our initial public offering, the offering terminated.

As a result of the offering, including the underwriters' option to purchase additional shares, we received net proceeds of \$55.6 million, after deducting total expenses of \$7.4 million, consisting of underwriting discounts and commissions of \$4.4 million and offering-related expenses of \$3.0 million. None of such payments were direct or indirect payments to any of the Company's directors or officers or their associates, to person owning 10% or more of our common stock, or to any of our affiliates.

**Table of Contents**

The net proceeds to us from our initial public offering have been invested in money market accounts and government and government agency securities.

There has been no material change in the planned use of proceeds from our initial public offering as described in our prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b) under the Securities Act.

**ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA**

You should read the following selected consolidated financial and other data below in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements, related notes, and other financial information included in this Annual Report on Form 10-K. The selected consolidated financial and other data in this section are not intended to replace the consolidated financial statements and are qualified in their entirety by the consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

The consolidated statements of operations data for the years ended December 31, 2012, 2011 and 2010 and the consolidated balance sheets data as of December 31, 2012 and 2011 are derived from our audited consolidated financial statements included elsewhere in this report. The consolidated statements of operations data for the years ended December 31, 2009 and 2008 and the consolidated balance sheets data as of December 31, 2010, 2009 and 2008 are derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. Historical results are not necessarily indicative of the results to be expected in the future.

	Years Ended December 31,				
	2012	2011	2010	2009	2008
	(in thousands, except share and per share data)				
<b>Consolidated statements of operations data:</b>					
Revenue	\$ 84,043	\$ 60,512	\$ 38,563	\$ 19,114	\$ 8,202
Cost of revenue (1)	29,060	23,202	16,284	8,954	4,273
Gross profit	54,983	37,310	22,279	10,160	3,929
Operating expenses (1):					
Research and development	19,925	16,511	10,868	6,210	4,663
General and administrative	9,928	6,631	4,209	2,485	2,389
Sales and marketing	42,719	37,722	33,098	21,067	14,729
Restructuring charges	1,345				
Total operating expenses	73,917	60,864	48,175	29,762	21,781
Loss from operations	(18,934)	(23,554)	(25,896)	(19,602)	(17,852)
Interest and other income, net	38	41	133	377	413
Loss before income taxes	(18,896)	(23,513)	(25,763)	(19,225)	(17,439)
Provision for income taxes	(40)	(23)			
Net loss	(18,936)	(23,536)	(25,763)	(19,225)	(17,439)
Accretion of redeemable convertible preferred stock		(128)	(210)	(210)	(210)
Net loss attributable to common stockholders	\$ (18,936)	\$ (23,664)	\$ (25,973)	\$ (19,435)	\$ (17,649)
Basic and diluted net loss per share attributable to common stockholders	\$ (0.74)	\$ (1.84)	\$ (5.90)	\$ (4.78)	\$ (4.61)



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Weighted-average number of common shares used in computing basic and diluted net loss per share	25,503,068	12,841,233	4,399,137	4,065,230	3,828,073
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**Table of Contents**

(1) Stock-based compensation included in the consolidated statements of operations data above was as follows:

	2012	Years Ended December 31,			2008
		2011	2010	2009	
		(in thousands)			
Cost of revenue	\$ 440	\$ 207	\$ 45	\$ 35	\$ 16
Research and development	1,199	511	171	88	38
General and administrative	1,579	346	227	188	89
Sales and marketing	913	381	99	79	60

	2012	2011	As of December 31,		2008
			2010	2009	
			(in thousands)		
<b>Consolidated balance sheet data:</b>					
Cash	\$ 40,341	\$ 59,842	\$ 13,855	\$ 28,276	\$ 2,543
Working capital (deficit)	(11,685)	18,838	(12,381)	12,595	12,266
Total assets	100,925	99,606	40,941	46,433	30,701
Deferred revenue, including current portion	75,206	59,696	38,722	23,144	9,401
Total liabilities	86,994	72,004	47,834	29,149	14,009
Preferred stock warrant liability			82	18	18
Redeemable and convertible stock			68,730	67,770	48,387
Total stockholders' equity (deficit)	13,931	27,602	(75,623)	(50,486)	(31,696)

	2012	2011	Years Ended December 31,		2008
			2010	2009	
			(in thousands, except percentage data)		
<b>Key metrics:</b>					
Total customers (1)	1,431	1,223	951	590	281
Annual retention rate (2)	84%	82%	83%	79%	81%
Renewal rate (3)	82%	82%	81%	78%	78%
Bookings (4)	\$ 98,488	\$ 80,900	\$ 54,141	\$ 32,857	\$ 14,069
Free cash flow (5)	\$ (4,065)	\$ (5,972)	\$ (12,204)	\$ (8,045)	\$ (12,409)

- (1) We define total customers as the number of paid Carbonite Home and Business subscriptions at the end of the relevant period.
- (2) We define annual retention rate as the percentage of customers on the last day of the prior year who remain customers on the last day of the current year, or for quarterly presentations, the percentage of customers on the last day of the comparable quarter in the prior year who remain customers on the last day of the current quarter.
- (3) We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented. Renewal rate excludes customers under our third-party distribution agreements and prior SMB offerings with subscriptions that remain active until cancelled.
- (4) We define bookings as revenue recognized during the period plus the change in total deferred revenue (excluding deferred revenue recorded in connection with acquisitions) during the same period.
- (5) We define free cash flow as net cash provided by (used in) operating activities, less capital expenditures, and adjusted for the cash portion of the lease exit charge.

Bookings and free cash flow are financial data that are not calculated in accordance with GAAP. The tables below provide reconciliation of bookings and free cash flow to revenue and cash provided by (used in) operating activities, respectively, the most directly comparable financial measures calculated and presented in accordance with GAAP.

**Table of Contents**

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

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

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

bookings does not reflect our receipt of payment from subscribers;

free cash flow does not reflect our future requirements for contractual commitments to vendors;

free cash flow does not reflect the non-cash component of employee compensation or depreciation and amortization of property and equipment; and

other companies in our industry may calculate bookings or free cash flow or similarly titled measures differently than we do, limiting their usefulness as comparative measures.

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

	Years Ended December 31,				
	2012	2011	2010	2009	2008
	(in thousands)				
Revenue	\$ 84,043	\$ 60,512	\$ 38,563	\$ 19,114	\$ 8,202
Add change in deferred revenue (excluding acquisition)	14,445	20,388	15,578	13,743	5,867
<b>Bookings</b>	<b>\$ 98,488</b>	<b>\$ 80,900</b>	<b>\$ 54,141</b>	<b>\$ 32,857</b>	<b>\$ 14,069</b>

	Years Ended December 31,				
	2012	2011	2010	2009	2008
	(in thousands)				
Cash provided by (used in) operating activities	\$ 9,195	\$ 7,572	\$ (1,552)	\$ (946)	\$ (7,705)
Add cash portion of lease exit charge	157				
Subtract capital expenditures	(13,417)	(13,544)	(10,652)	(7,099)	(4,704)

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Free cash flow	\$ (4,065)	\$ (5,972)	\$ (12,204)	\$ (8,045)	\$ (12,409)
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**Table of Contents**

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. The following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in Risk Factors.*

**Overview**

We are a leading provider of cloud backup solutions for consumers and SMBs. We provide easy-to-use, affordable, and secure cloud backup solutions with anytime, anywhere access to files stored on our servers. We believe that we are the best known brand in the cloud backup market.

In 2005, we began development of our cloud backup solution and raised our first capital from investors. We sold the first Carbonite subscription in 2006. In 2010, we introduced our SMB solution and expanded our management team to better focus on our consumer and SMB markets. We surpassed 100,000 subscribers in 2008, 500,000 subscribers in 2009, and 1,000,000 subscribers in early 2011. As of December 31, 2012, we had subscribers in more than 100 countries, with subscribers based in the U.S. representing 94% of our total revenue for 2012.

We derive our revenue from subscription fees from consumers and SMBs. We charge consumers a \$59 flat fee for one year of unlimited cloud backup with our Carbonite Home solution. Our Carbonite HomePlus and Carbonite HomePremier solutions provide consumers with additional features at annual prices of \$99 and \$149, respectively. The pricing of all of our consumer solutions is discounted for multi-year subscriptions. Our SMB solutions, Carbonite Business and Carbonite BusinessPremier, allow for an unlimited number of users, subject to storage limits, and are priced starting at \$229 and \$599 per year, respectively. We charge customers the full subscription amount at the beginning of each subscription period. We initially record a subscription fee as deferred revenue and then recognize it ratably over the subscription period. The annual or multi-year commitments of our customers enhance management's visibility of our revenue and charging customers at the beginning of the subscription period provides working capital.

In October 2012, we acquired Zmanda, Inc. for \$13.4 million, net of cash acquired. We believe that this acquisition will enhance our SMB offering with the ability to backup databases and file systems to the cloud, and will enable SMBs to obtain all of the backup solutions that they need from one vendor.

We are investing aggressively in customer acquisition because we believe that the market for cloud backup is in the early stages of development. Our largest expense is advertising for customer acquisition, which is recorded as sales and marketing expense. This is comprised of television and radio advertising, online display advertising, print advertising, paid search, direct marketing, and other expenses. Our total advertising expense in 2012, 2011, and 2010 was \$24.1 million, \$25.1 million, and \$23.6 million, respectively. We generally spend more on advertising in the first and third quarters of each year based on the seasonality of customer purchasing patterns and fluctuations in advertising rates. In January 2012, we launched a new distribution strategy designed to sell large volumes of our solutions through our sales channel relationships including major retailers and resellers.

As we grow our business we continue to invest in additional storage and infrastructure. Our capital expenditures in 2012, 2011, and 2010 were \$13.4 million, \$13.5 million, and \$10.7 million, respectively.

Our revenue has grown from \$38.6 million in 2010 to \$60.5 million in 2011 and \$84.0 million in 2012. At the same time, our total operating costs have grown from \$48.2 million in 2010 to \$60.9 million in 2011 and

## **Table of Contents**

\$73.9 million in 2012, principally as a result of our investment in customer acquisition and research and development. We expect to continue to devote substantial resources to customer acquisition, improving our technologies, and expanding our solutions. In addition, we expect to invest heavily in our operations to support anticipated growth and public company reporting and compliance obligations. We defer revenue over our customers' subscription periods, but expense marketing costs as incurred. As a result of these factors, we expect to continue to incur GAAP operating losses on an annual basis for the foreseeable future.

### **Our Business Model**

We evaluate the profitability of a customer relationship over its lifecycle because of the nature of our business model. As we generally incur customer acquisition costs and capital equipment costs in advance of subscriptions while recognizing revenue ratably over the terms of the subscriptions. As a result, a customer relationship may not be profitable or result in positive cash flow at the beginning of the subscription period, even though it may be profitable or result in positive cash flow over the life of the customer relationship. While we offer both annual and multi-year subscription plans, a significant majority of our customers are currently on annual subscription plans. We typically generate positive cash flow during the first year of a multi-year subscription as we charge the subscription fee for the entire period at the beginning of the subscription.

### **Key Business Metrics**

Our management regularly reviews a number of financial and operating metrics, including the following key metrics, to evaluate our business:

*Total customers.* We calculate total customers as the number of paid Carbonite Home and Business subscriptions at the end of the relevant period. Each consumer subscription covers a single computer; therefore, a consumer with multiple computers would have multiple subscriptions. Each SMB subscription covers all computers of the SMB entity; therefore, an SMB with multiple computers would have one subscription.

*Annual retention rate.* We calculate annual retention rate as the percentage of customers on the last day of the prior year who remain customers on the last day of the current year, or for quarterly presentations, the percentage of customers on the last day of the comparable quarter in the prior year who remain customers on the last day of the current quarter. Our management uses these measures to determine the stability of our customer base and to evaluate the lifetime value of our customer relationships.

*Renewal rate.* We define renewal rate for a period as the percentage of customers who renew annual or multi-year subscriptions that expire during the period presented. Renewal rate excludes customers under our discontinued third-party distribution agreements and prior SMB offerings with subscriptions that remain active until cancelled. Our management uses this measure to monitor trends in customer renewal activity.

*Bookings.* We calculate bookings as revenue recognized during a particular period plus the change in total deferred revenue (excluding deferred revenue recorded in connection with acquisitions) during the same period. Our management uses this measure as a proxy for cash receipts. Bookings represent the aggregate dollar value of customer subscriptions received by us during a period. We initially record a subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the life of the subscription period.

*Free cash flow.* We calculate free cash flow as net cash provided by (used in) operating activities, less purchases of property and equipment, and adjusted for the cash portion of the lease exit charge. Our management uses this measure to evaluate our operating results.

**Table of Contents**

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

**Performance Highlights**

The following table presents our performance highlights for the periods presented:

	Years Ended December 31,		
	2012	2011	2010
	(in thousands, except percentage data)		
<b>Key metrics:</b>			
Total customers	1,431	1,223	951
Annual retention rate	84%	82%	83%
Renewal rate	82%	82%	81%
Bookings	\$ 98,488	\$ 80,900	\$ 54,141
Free cash flow	\$ (4,065)	\$ (5,972)	\$ (12,204)

Our total customers and bookings increased over the periods presented and we continue to invest in customer acquisition in an effort to drive continued growth in total customers and bookings. While we expect our total customers to continue to increase on an absolute basis, we expect that our annual percentage increase in total customers will decline as our customer base grows.

In June 2010, we decided to cease distribution of our consumer solutions through third-party distribution channels, and we terminated most of our distribution agreements at that time. During 2010, subscriptions purchased through third-party distributors accounted for 8% of our revenue. Historically, renewal rates for subscriptions purchased through third-party distributors were lower than for direct sales. Excluding renewal activity related to third-party distributor sales, our annual retention rates for the years ended December 31, 2012, December 31, 2011, and December 31, 2010 were 85%, 86%, and 85% respectively.

Our free cash flow over the periods presented has improved due to economies of scale and the impact of higher per customer profitability associated with consistently strong renewal rates. Free cash flow for the year ended December 31, 2012 improved by \$1.9 million and \$8.1 million compared to the years ended December 31, 2011 and December 31, 2010, respectively.

**Key Components of our Consolidated Statements of Operations***Revenue*

We derive our revenue from subscription fees from consumers and SMBs. We typically charge a customer's credit card the full price of the subscription at the commencement of the subscription period and at each renewal date, unless the customer decides not to renew the subscription. We initially record a customer subscription fee as deferred revenue and then recognize it ratably, on a daily basis, over the life of the subscription period.

*Cost of revenue*

Cost of revenue consists primarily of costs associated with our data center operations and customer support centers, including wages and benefits for personnel, depreciation of equipment, amortization of developed technology, rent, utilities and broadband, equipment maintenance, software license fees, and allocated overhead. The expenses related to hosting our services and supporting our customers are related to the number of customers and the complexity of our services and hosting infrastructure. We expect these expenses to increase in absolute

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## **Table of Contents**

dollars as we continue to increase our number of customers. On a per subscriber basis, our costs have been decreasing as we purchase equipment and services in larger quantities and our customer support personnel become more efficient in supporting our customers. We have also experienced a downward trend in the cost of storage equipment and broadband service, which we expect will continue in the future.

### *Gross profit and gross margin*

Our gross margins have historically expanded due to price increases for our consumer solutions, the introduction of higher priced offerings targeting both consumers and SMBs, cost savings resulting from a downward trend in the cost of storage equipment and services, and efficiencies of our customer support personnel in supporting our customers. We expect these trends to continue.

### *Operating expenses*

*Research and development.* Research and development expenses consist primarily of wages and benefits for development personnel, consulting fees, rent, and depreciation. We have focused our research and development efforts on both improving ease of use and functionality of our existing solutions and developing new offerings. The majority of our research and development employees are located at our corporate headquarters in the U.S. We expect that research and development expenses will increase in absolute dollars on an annual basis as we continue to enhance and expand our services.

*General and administrative.* General and administrative expenses consist primarily of wages and benefits for management, finance, accounting, human resources, legal and other administrative personnel, legal and accounting fees, insurance, and other corporate expenses. We expect that general and administrative expenses will increase in absolute dollars on an annual basis as we continue to add personnel and enhance our internal information systems in connection with the anticipated growth of our business and incur costs related to operating as a public company.

*Sales and marketing.* Sales and marketing expenses consist primarily of advertising costs, wages and benefits for sales and marketing personnel, creative expenses for advertising programs, credit card fees, commissions paid to third-party partners and affiliates, and the cost of providing free trials. The largest component of sales and marketing expense is advertising for customer acquisition, principally television, radio, online, and print advertisements. Online search costs consist primarily of pay-per-click payments to search engine operators. Advertising costs are expensed as incurred. To date, marketing and advertising costs have been incurred principally in the U.S., but we may increase our marketing and advertising expenditures in other countries. We expect that we will continue to commit significant resources to our sales and marketing efforts to grow our business and awareness of our brand and solutions. We expect that sales and marketing expenses will continue to increase in absolute dollars on an annual basis, but decrease as a percentage of revenue.

*Restructuring charges.* Restructuring charges consists of the accrual of future remaining lease payments associated with the March 2012 closure of our Boston, Massachusetts data center and moving expenses to relocate equipment formerly hosted in that facility and the December 2012 personnel related restructuring of our operations in China. See Notes 12 and 13 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information.

### **Critical Accounting Policies**

Our financial statements are prepared in accordance with accounting principles generally accepted in the U.S., or GAAP. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions, and judgments that affect the reported amount of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances, but all such estimates and assumptions are inherently uncertain



## **Table of Contents**

and unpredictable. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from those estimates and assumptions, and it is possible that other professionals, applying their own judgment to the same facts and circumstances, could develop and support alternative estimates and assumptions that would result in material changes to our operating results and financial condition. Our most critical accounting policies are summarized below.

See Note 2 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information about these critical accounting policies, as well as a description of our other significant accounting policies.

### *Revenue recognition*

We derive revenue from cloud backup subscription services. These services are stand-alone independent service solutions, which are generally contracted for a one- to three-year term. Subscription agreements include access to use our solutions via the internet. We recognize revenue in accordance with the Financial Accounting Standards Codification (ASC) 605-10, *Overall Revenue Recognition*. Subscription revenue is recognized ratably on a daily basis upon activation over the subscription period, when persuasive evidence of an arrangement with a customer exists, the subscription period has been activated, the price is fixed or determinable, and collection is reasonably assured. Deferred revenue represents payments received from customers for subscription services prior to recognizing the revenue related to those payments.

### *Business Combinations*

In accordance with ASC 805, *Business Combinations*, the Company allocates the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. Determining these fair values requires management to make significant estimates and assumptions, especially with respect to intangible assets.

The fair value of identifiable intangible assets is based on detailed valuations that use information and assumptions provided by management, which consider management's best estimates of inputs and assumptions that a market participant would use. Our identifiable intangible assets acquired consist of developed technology, customer relationships, tradenames, and non-compete agreements. Developed technology consists of products that have reached technological feasibility and tradenames represent acquired company and product names. Customer relationships represent the underlying relationships and agreements with customers of the acquired company's installed base. Non-compete agreements represent the protection against the loss of business and resultant cash flows from direct competition. We estimate the useful lives of our intangible assets based upon the expected period over which we anticipate generating economic benefits from the related intangible asset.

### *Goodwill and acquired intangible assets*

We record goodwill when consideration paid in a business acquisition exceeds the fair value of the net tangible assets and the identified intangible assets acquired. Our estimates of fair value are based upon assumptions believed to be reasonable at that time, but that are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and unanticipated events or circumstances may occur, that may affect the accuracy or validity of such assumptions, estimates or actual results. Goodwill is not amortized, but rather is tested for impairment annually or more frequently if facts and circumstances warrant a review. We perform our assessment for impairment of goodwill on an annual basis and we have determined that there is a single reporting unit for the purpose of conducting this annual goodwill impairment assessment. For purposes of assessing potential impairment, we estimate the fair value of the reporting unit (based on our market capitalization) and compare this amount to the carrying value of the reporting unit (as reflected by our total stockholders' equity). If we determine that the carrying value of the reporting unit exceeds its fair value, an impairment charge would be required. Our annual goodwill impairment test is at November 30 of each year. To date, we have not identified any impairment to goodwill.

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## **Table of Contents**

Intangible assets acquired in a business combination are recorded under the acquisition method of accounting at their estimated fair values at the date of acquisition. We amortize acquired intangible assets over their estimated useful lives based on the pattern of consumption of the economic benefits or, if that pattern cannot be readily determined, on a straight-line basis. We review our intangible assets with definite lives for impairment, in conjunction with its other long-lived assets, whenever events or changes in circumstances indicate that the carrying amount of any of these assets may not be recoverable. If the recoverability of these assets is considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds its estimated fair value. We have not identified any impairment of its long-lived assets as of December 31, 2012, 2011, and 2010.

### *Income taxes*

We provide for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization. We account for uncertain tax positions recognized in our consolidated financial statements by prescribing a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

Due to a history of losses, we have provided a full valuation allowance against our deferred tax assets as more fully described in Note 11 of our consolidated financial statements. The ability to utilize these losses, any future losses, and any other tax credits or attributes may be restricted or eliminated by changes in our ownership, changes in legislation, and other rules affecting the ability to offset future taxable income with losses from prior periods. Future determinations on the need for a valuation allowance on our net deferred tax assets will be made on an annual basis, and our assessment at December 31, 2012 reflects a continued need for a full valuation allowance.

### *Stock-based compensation*

Accounting guidance requires employee stock-based payments to be accounted for under the fair value method. Under this method, we are required to record compensation cost based on the estimated fair value for stock-based awards granted amortized over the requisite service periods for the individual awards, which generally equals the vesting periods. We use the straight-line amortization method for recognizing stock-based compensation expenses.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards requires the use of highly subjective estimates and assumptions, including the estimated fair value of our common stock. Following our initial public offering, we used the quoted market price of our common stock to establish the fair value of the common stock underlying our stock options. Because there was no public market for our common stock prior to our initial public offering, our board of directors determined the fair value of our common stock with input from management, based on reports of an unrelated third-party valuation specialist.

We estimate the fair value of stock options on the date of grant using the Black-Scholes option-pricing model, which further requires the use of highly subjective estimates and assumptions, including expected stock price volatility, expected term of an award, risk-free interest rate, and expected dividend yield. As a public company with limited trading history, we consider both the volatility of our stock price and that of our publicly traded peer companies. The expected life assumption is based on the simplified method for estimating expected term as we do not have sufficient stock option exercise experience to support a reasonable estimate of the expected term. The risk-free interest rate is based on the implied yield currently available on U.S. Treasury zero-coupon issues with terms approximately equal to the expected life of the stock option. We use an expected dividend rate of zero as we currently have no history or expectation of paying cash dividends on our capital stock.

**Table of Contents****Results of Operations**

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

	Years Ended December 31,		
	2012	2011	2010
(in thousands)			
<b>Consolidated statements of operations data:</b>			
Revenue	\$ 84,043	\$ 60,512	\$ 38,563
Cost of revenue	29,060	23,202	16,284
Gross profit	54,983	37,310	22,279
Operating expenses:			
Research and development	19,925	16,511	10,868
General and administrative	9,928	6,631	4,209
Sales and marketing	42,719	37,722	33,098
Restructuring charges	1,345		
Total operating expenses	73,917	60,864	48,175
Loss from operations	(18,934)	(23,554)	(25,896)
Interest and other income, net	38	41	133
Loss before income taxes	(18,896)	(23,513)	(25,763)
Provision for income taxes	(40)	(23)	
Net loss	(18,936)	(23,536)	(25,763)
Accretion of redeemable convertible preferred stock		(128)	(210)
Net loss attributable to common stockholders	\$ (18,936)	\$ (23,664)	\$ (25,973)

	Years Ended December 31,		
	2012	2011	2010
(% of revenue)			
<b>Consolidated statements of operations data:</b>			
Revenue	100%	100%	100%
Cost of revenue	34.6	38.3	42.2
Gross profit	65.4	61.7	57.8
Operating expenses:			
Research and development	23.7	27.3	28.2
General and administrative	11.8	11.0	10.9
Sales and marketing	50.8	62.3	85.8
Restructuring charges	1.6		
Total operating expenses	87.9	100.6	124.9

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Loss from operations	(22.5)	(38.9)	(67.2)
Interest and other income (expense), net			0.4
Loss before income taxes	(22.5)	(38.9)	(66.8)
Provision for income taxes			
Net loss	(22.5)%	(38.9)%	(66.8)%

**Table of Contents****Comparison of Years Ended December 31, 2012, 2011, and 2010***Revenue*

	Years Ended December 31,			2011 to 2012	2010 to 2011
	2012	2011	2010	% Change	% Change
	(in thousands, except percentage data)				
Revenue	\$ 84,043	\$ 60,512	\$ 38,563	38.9%	56.9%

Revenue increased by \$23.5 million from 2011 to 2012 and by \$21.9 million from 2010 to 2011, primarily due to increases in the average selling prices for our consumer and SMB offerings and also due to 17.0% and 28.5% increases in the number of total customers in 2012 and 2011, respectively. Revenue from our SMB offerings was approximately \$12.0 million in 2012 compared to \$5.8 million in 2011.

*Cost of revenue, gross profit, and gross margin*

	Years Ended December 31,			2011 to 2012	2010 to 2011
	2012	2011	2010	% Change	% Change
	(in thousands, except percentage data)				
Cost of revenue	\$ 29,060	\$ 23,202	\$ 16,284	25.2%	42.5%
Gross profit	54,983	37,310	22,279	47.4%	67.5%
Gross margin	65.4%	61.7%	57.8%		

Cost of revenue increased by \$5.9 million from 2011 to 2012 and by \$6.9 million from 2010 to 2011, primarily due to an increase in the total number of customers. The increase in cost of revenue from 2011 to 2012 was comprised primarily of hosting costs of \$5.1 million, including depreciation of equipment, personnel related costs of our operations employees, and increases in our data storage capacity, and an increase in customer support costs of \$0.8 million, primarily attributable to increased personnel related costs of our customer support employees, partially offset by lower third-party outsourcing costs as a result of having replaced our outsourced support in India during 2011. The increase in cost of revenue from 2010 to 2011 was comprised primarily of hosting costs of \$5.5 million, including depreciation of equipment, personnel related costs of our operations employees, and increases in our data storage capacity, and an increase in customer support costs of \$1.4 million, primarily associated with the cost of new employees to replace outsourced support in India. Gross profit increased primarily as a result of operating efficiencies primarily due to economies of scale and our higher priced consumer and SMB offerings.

*Operating expenses*

	Years Ended December 31,			2011 to 2012	2010 to 2011
	2012	2011	2010	% Change	% Change
	(in thousands, except percentage data)				
Research and development	\$ 19,925	\$ 16,511	\$ 10,868	20.7%	51.9%
General and administrative	9,928	6,631	4,209	49.7%	57.5%
Sales and marketing	42,719	37,722	33,098	13.2%	14.0%
Restructuring charges	1,345			100.0%	

*Research and development.* Research and development expenses increased by \$3.4 million from 2011 to 2012 and by \$5.6 million from 2010 to 2011, primarily due to personnel related costs associated with additional hiring to enhance the functionality of our solutions and to develop new offerings.

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## **Table of Contents**

*General and administrative.* General and administrative expenses increased by \$3.3 million from 2011 to 2012 and by \$2.4 million from 2010 to 2011. In both years, we increased the number of general and administrative employees to support our overall growth. The overall increases consisted primarily of increases of \$0.9 million and \$1.5 million in professional fees, including legal and accounting fees, from 2011 to 2012 and 2010 to 2011, respectively, and increases of \$1.9 million and \$0.4 million in personnel related and recruiting costs from 2011 to 2012 and 2010 to 2011, respectively.

*Sales and marketing.* Sales and marketing expenses increased by \$5.0 million from 2011 to 2012 and by \$4.6 million from 2010 to 2011. The increase from 2011 to 2012 was attributable to an increase in advertising campaigns and other marketing expenses of \$1.7 million and an increase in personnel related costs of \$2.0 million, as a result of hiring new employees. In addition, costs related to free trials increased by \$1.1 million. The increase from 2010 to 2011 was attributable to an increase in advertising campaigns of \$1.5 million and an increase in personnel related costs of \$1.1 million, as a result of hiring new employees. In addition, credit card processing fees increased by \$0.8 million and costs related to free trials increased by \$1.2 million.

*Restructuring charges.* Restructuring charges increased by \$1.3 million from 2011 to 2012. This increase was attributable to the March 2012 closure of our Boston, Massachusetts data center and the relocation of the equipment formerly hosted in that facility of \$1.1 million and the December 2012 personnel related restructuring of our operations in China of \$0.2 million. See Notes 12 and 13 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information.

## **Liquidity and Capital Resources**

As of December 31, 2012, we had cash and cash equivalents of \$40.3 million, which primarily consisted of cash and money market funds. In connection with our initial public offering in August 2011, we received net proceeds of \$55.6 million. Prior to our initial public offering, we had funded our operations primarily through prepayment of subscriptions and the sale of \$68.8 million of preferred stock, all of which was converted into shares of our common stock in connection with our initial public offering. Our principal uses of cash are funding our operations and capital expenditures. In June 2011, we used \$1.9 million of cash to acquire substantially all of the assets of Phanfare, Inc., which operates a service that enables users to create, maintain, and share online photo and video albums. In October 2012, we used \$13.4 million of cash to acquire all of the outstanding capital stock of Zmanda, Inc., a provider of open source and cloud backup solutions.

### *Sources of funds*

We believe, based on our current operating plan, that our existing cash and cash equivalents, marketable securities, and borrowings available under our revolving credit facility will be sufficient to meet our anticipated cash needs for at least the next 12 months.

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

In September 2012, we amended and renewed our revolving bank credit facility in order to extend the term of the facility through August 31, 2013 and increased the maximum amount of indebtedness that we may incur to \$25 million. Advances under the credit facility bear interest on the outstanding daily balance, at an annual rate equal to the lender's prime reference rate plus 0.25%. We have pledged our accounts receivable, equipment, and shares of our subsidiaries to the lender to collateralize our obligations under the credit facility. We have also agreed not to grant a security interest in or pledge our intellectual property to any third party. The credit facility

**Table of Contents**

contains customary events of default, conditions to borrowings and restrictive covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur additional debt, incur liens, make distributions to our stockholders, make investments, or enter into certain types of related party transactions. The credit facility also includes financial and other covenants including covenants to maintain a minimum current ratio, a minimum number of total subscribers, and a restriction as to where we may hold the majority of our cash and investments. To date, we have not drawn down on our revolving credit facility. Any inability to meet our debt service obligations could adversely affect our financial position and liquidity.

*Uses of funds*

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

the levels of advertising and promotion required to acquire and retain customers;

expansion of our data center infrastructure necessary to support our growth;

growth of our operations in the U.S. and worldwide;

our development and introduction of new solutions; and

the expansion of our sales, customer support, research and development, and marketing organizations.

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

*Cash flows*

The following table summarizes our cash flow data for 2012, 2011, and 2010.

	Years Ended December 31,		
	2012	2011 (in thousands)	2010
Net cash provided by (used in) operating activities	\$ 9,195	\$ 7,572	\$ (1,552)
Net cash used in investing activities	(29,802)	(18,187)	(13,913)
Net cash provided by financing activities	1,102	56,600	1,041

*Operating activities*

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

In 2012, cash provided by operating activities was \$9.2 million, which was primarily driven by a \$14.4 million increase in deferred revenue associated with the increase in subscription sales and customer growth. Net cash inflows from operating activities included non-cash charges of \$16.3 million, including \$10.8 million of depreciation and amortization and \$4.1 million of stock-based compensation. These cash inflows were partially offset by our net loss of \$18.9 million, a decrease in accounts payable and accrued expenses of \$1.8 million, and a \$0.6 million increase

in prepaid expenses and other current assets.



## **Table of Contents**

In 2011, cash provided by operating activities was \$7.6 million, which was primarily driven by a \$20.4 million increase in deferred revenue associated with the increase in subscription sales and customer growth. Net cash inflows from operating activities included non-cash charges of \$9.3 million, including \$7.9 million of depreciation and amortization and \$1.4 million of stock-based compensation. An increase in accounts payable and accrued expenses provided an additional \$2.8 million. These cash inflows were partially offset by our net loss of \$23.5 million and a \$1.2 million increase in prepaid expenses and other current assets.

In 2010, we used \$1.6 million in operating activities, which was primarily driven by our net loss of \$25.8 million, offset by a \$15.6 million increase in deferred revenue associated with the increase in subscription sales and customer growth, non-cash charges of \$5.6 million, including \$5.1 million of depreciation and \$0.5 million of stock-based compensation, and a \$3.0 million increase in current liabilities.

### *Investing activities*

In 2012, cash used in investing activities was \$29.8 million, consisting primarily of capital expenditures of \$13.4 million primarily for server equipment and other data center infrastructure, an increase in restricted cash of \$0.5 million, and the use of \$13.4 million, net of cash acquired, in connection with the acquisition of Zmanda, Inc. In addition, purchases and maturities of marketable securities netted to a \$2.5 million use of cash.

In 2011, cash used in investing activities was \$18.2 million, consisting primarily of capital expenditures of \$13.5 million primarily for server equipment and other data center infrastructure and the use of \$1.9 million of net cash in connection with the acquisition of substantially all of the assets of Phanfare, Inc. In addition, purchases and maturities of marketable securities netted to a \$2.7 million use of cash.

In 2010, we used \$13.9 million in investing activities, consisting primarily of \$10.7 million for the purchase of equipment, in addition to a net investment of \$3.3 million in marketable securities.

### *Financing activities*

Cash provided by financing activities in 2012 was \$1.1 million from the proceeds from the exercise of stock options.

Cash provided by financing activities in 2011 was \$56.6 million, consisting of \$55.6 million of net proceeds from our initial public offering and \$1.0 million from the proceeds from the exercise of stock options.

Cash provided by financing activities in 2010 was \$1.0 million, consisting primarily of net proceeds of \$0.8 million from the issuance of shares of Series D convertible preferred stock and \$0.3 million from the proceeds from the exercise of stock options.

### *Off-balance sheet arrangements*

As of December 31, 2012, we did not have any off-balance sheet arrangements.

**Table of Contents***Contractual obligations*

The following table summarizes our contractual obligations at December 31, 2012 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

	Total	Payment Due by Period		
		Less Than 1 Year	1-3 Years	3-5 Years
Office lease obligations	\$ 5,921	\$ 1,807	\$ 2,706	\$ 1,408
Hosting facility lease obligations (1)	4,733	1,588	3,082	63
Other purchase commitments	6,616	5,029	1,587	
Total	\$ 17,270	\$ 8,424	\$ 7,375	\$ 1,471

- (1) Does not include \$1.0 million related to our Boston, Massachusetts data center that we vacated in March 2012 and for which we have accrued \$1.0 million as part of our restructuring charges. See Notes 12 and 13 to our financial statements included elsewhere in this Annual Report on Form 10-K for additional information.

The commitments under our office lease obligations shown above consist primarily of lease payments for our Boston, Massachusetts corporate headquarters and our Lewiston, Maine customer support facility.

We also lease small amounts of general office space in Sunnyvale, California, Princeton, New Jersey, and Beijing, China under lease agreements that expire at various dates through March 2014.

Our Lewiston, Maine support facility lease expires on June 1, 2016. We may terminate this lease at any time after May 31, 2013. The lease contains a renewal option for an additional two years, and requires us to pay a proportion of increases in operating expenses and real estate taxes after January 1, 2013.

The commitment under our hosting facility obligations shown above consists of Somerville, Massachusetts, Wakefield, Massachusetts, and Phoenix, Arizona data centers.

Other purchase commitments shown above consist of contractual commitments to various vendors primarily for advertising, marketing, and broadband services.

**Recent Accounting Pronouncements**

Effective January 1, 2012, we adopted ASU No. 2011-08, *Testing Goodwill for Impairment (the revised standard)*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The adoption of this guidance did not have an effect on our consolidated financial statements.

Effective January 1, 2012, we adopted ASU No. 2011-05, *Presentation of Comprehensive Income*. Under this guidance, we can present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. We elected to present comprehensive income using two separate but consecutive statements. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. As the new guidance relates only to how comprehensive income is disclosed and does not change the items that must be reported as comprehensive income, adoption did not have an effect on our consolidated financial statements.

**Table of Contents**

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risks in the ordinary course of our business. These risks include primarily interest rate fluctuation risks and foreign exchange risks.

*Interest Rate Fluctuation Risk*

Our cash consists of interest bearing bank accounts. We did not have long-term borrowings as of December 31, 2012. Interest income is sensitive to changes in the general level of U.S. interest rates. The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Our cash equivalents and marketable securities are relatively insensitive to interest rate changes. In future periods, we will continue to evaluate our investment policy in order to ensure that we continue to meet our overall objectives. In the event that we borrow under our revolving credit facility, which bears interest at the lender's prime rate plus 0.25%, we would be exposed to interest rate fluctuations.

*Foreign Currency Exchange Risk*

We have foreign currency risks related to our operating expenses and potential revenue denominated in currencies other than the U.S. dollar, principally the Chinese Yuan. We do not believe movements in the foreign currencies in which we transact will significantly affect future net earnings. Foreign currency risk can be quantified by estimating the change in cash flows resulting from a hypothetical 10% adverse change in foreign exchange rates. We believe such a change would not have a material impact on our results of operations.

**Table of Contents**

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**  
**Carbonite, Inc.**

**Index to Consolidated Financial Statements**

	<b>Page</b>
<u>Report of Independent Registered Public Accounting Firm</u>	51
<u>Consolidated Balance Sheets</u>	52
<u>Consolidated Statements of Operations</u>	53
<u>Consolidated Statements of Comprehensive Loss</u>	54
<u>Consolidated Statements of Redeemable and Convertible Preferred Stock and Stockholders' Equity (Deficit)</u>	55
<u>Consolidated Statements of Cash Flows</u>	56
<u>Notes to Consolidated Financial Statements</u>	57

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of

Carbonite, Inc.

We have audited the accompanying consolidated balance sheets of Carbonite, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive loss, redeemable and convertible preferred stock, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Carbonite, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Carbonite Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 6, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts

March 6, 2013

**Table of Contents****Carbonite, Inc.****Consolidated Balance Sheets**

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
	(In thousands, except share and per share data)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 40,341	\$ 59,842
Marketable securities	14,990	12,684
Accounts receivable, net of allowance	1,549	944
Prepaid expenses and other current assets	2,369	1,730
Restricted cash	500	
Total current assets	59,749	75,200
Property and equipment, net	24,622	21,648
Other assets	147	189
Acquired intangible assets, net	4,871	1,055
Goodwill	11,536	1,514
Total assets	\$ 100,925	\$ 99,606
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 6,247	\$ 6,858
Accrued expenses	5,068	4,999
Current portion of deferred revenue	60,119	44,505
Total current liabilities	71,434	56,362
Deferred revenue, net of current portion	15,087	15,191
Other long-term liabilities	473	451
Total liabilities	86,994	72,004
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 6,000,000 shares authorized; no shares issued		
Common stock, \$0.01 par value; 45,000,000 shares authorized at December 31, 2012 and 2011, respectively; 25,806,123 and 25,137,342 shares outstanding at December 31, 2012 and 2011, respectively	258	251
Additional paid-in capital	133,059	127,807
Accumulated deficit	(119,373)	(100,437)
Treasury stock, at cost (2,009 shares)	(22)	(22)
Accumulated other comprehensive income	9	3
Total stockholders' equity	13,931	27,602
Total liabilities and stockholders' equity	\$ 100,925	\$ 99,606

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

**Table of Contents****Carbonite, Inc.****Consolidated Statements of Operations**

	Years Ended December 31,		
	2012	2011	2010
	(In thousands, except share and per share data)		
Revenue	\$ 84,043	\$ 60,512	\$ 38,563
Cost of revenue	29,060	23,202	16,284
Gross profit	54,983	37,310	22,279
Operating expenses:			
Research and development	19,925	16,511	10,868
General and administrative	9,928	6,631	4,209
Sales and marketing	42,719	37,722	33,098
Restructuring charges	1,345		
Total operating expenses	73,917	60,864	48,175
Loss from operations	(18,934)	(23,554)	(25,896)
Interest and other income, net	38	41	133
Loss before income taxes	(18,896)	(23,513)	(25,763)
Provision for income taxes	(40)	(23)	
Net loss	(18,936)	(23,536)	(25,763)
Accretion of redeemable convertible preferred stock		(128)	(210)
Net loss attributable to common stockholders	\$ (18,936)	\$ (23,664)	\$ (25,973)
Basic and diluted net loss per share attributable to common stockholders	\$ (0.74)	\$ (1.84)	\$ (5.90)
Weighted-average number of common shares used in computing basic and diluted net loss per share	25,503,068	12,841,233	4,399,137

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**Table of Contents**

**Carbonite, Inc.**

**Consolidated Statements of Comprehensive Loss**

	<b>Years Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>		
Net loss	\$ (18,936)	\$ (23,536)	\$ (25,763)
Other comprehensive income:			