BLACKBAUD INC
Form 10-Q
August 04, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
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: 000-50600

Blackbaud, Inc.
(Exact name of registrant as specified in its charter)

Delaware	11-2617163
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2000 Daniel Island Drive
Charleston, South Carolina 29492
(Address of principal executive offices, including zip code)
(843) 216-6200
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES þ 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES þ NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ¨ NO þ
The number of shares of the registrant’s Common Stock outstanding as of July 24, 2017 was 48,061,063.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the documents incorporated herein by reference, contains forward-looking statements that anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. These "forward-looking statements" are made subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build and grow our business, our operating results, our ability to successfully integrate acquired businesses and technologies, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the impact of expensing stock-based compensation, the sufficiency of our capital resources, our ability to meet our ongoing debt and obligations as they become due, and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as “believes,” “seeks,” “expects,” “may,” “might,” “should,” “intends,” “could,” “would,” “likely,” “will,” “targets,” “plans,” “anticipates,” “aims,” “projects,” “estimates” or any such words and similar expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Accordingly, they should not be viewed as assurances of future performance, and actual results may differ materially and adversely from those expressed in any forward-looking statements.

Important factors that could cause actual results to differ materially from our expectations expressed in forward-looking statements include, but are not limited to, those summarized under “Item 1A. Risk factors” and elsewhere in this report, in our Annual Report on Form 10-K for the year ended December 31, 2016 and in our other SEC filings. Forward-looking statements represent our management's beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statement, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Blackbaud, Inc.
Consolidated balance sheets
(Unaudited)

(dollars in thousands)	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 17,268	$ 16,902
Restricted cash due to customers	289,232	353,771
Accounts receivable, net of allowance of $3,738 and $3,291 at June 30, 2017 and December 31, 2016, respectively	129,890	88,932
Prepaid expenses and other current assets	51,285	48,314
Total current assets	487,675	507,919
Property and equipment, net	45,679	50,269
Software development costs, net	44,962	37,582
Goodwill	472,643	438,240
Intangible assets, net	263,347	253,676
Other assets	24,080	22,524
Total assets	$ 1,338,386	$ 1,310,210
Liabilities and stockholders’ equity		
Current liabilities:		
Trade accounts payable	$ 17,660	$ 23,274
Accrued expenses and other current liabilities	46,508	54,196
Due to customers	289,232	353,771
Debt, current portion	7,500	4,375
Deferred revenue, current portion	280,816	244,500
Total current liabilities	641,716	680,116
Debt, net of current portion	380,162	338,018
Deferred tax liability	40,780	29,558
Deferred revenue, net of current portion	6,067	6,440
Other liabilities	7,572	8,533
Total liabilities	1,076,297	1,062,665
Commitments and contingencies (see Note 10)		
Stockholders’ equity:		
Preferred stock; 20,000,000 shares authorized, none outstanding	—	—
Common stock, $0.001 par value; 180,000,000 shares authorized, 58,456,066 and 57,672,401 shares issued at June 30, 2017 and December 31, 2016, respectively	58	58
Additional paid-in capital	330,559	310,452
Treasury stock, at cost; 10,397,768 and 10,166,801 shares at June 30, 2017 and December 31, 2016, respectively	(231,881)	(215,237)
Accumulated other comprehensive loss	(558)	(457)
Retained earnings	163,911	152,729
Total stockholders’ equity	262,089	247,545
Total liabilities and stockholders’ equity	$ 1,338,386	$ 1,310,210

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

Blackbaud, Inc.
Consolidated statements of comprehensive income
(Unaudited)

(dollars in thousands, except per share amounts)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenue				
Subscriptions	$125,252	$104,039	$243,431	$200,890
Maintenance	32,917	37,449	66,698	74,609
Services and other	34,026	38,703	65,687	73,948
Total revenue	192,195	180,191	375,816	349,447
Cost of revenue				
Cost of subscriptions	57,365	52,163	112,291	101,829
Cost of maintenance	5,871	5,698	11,853	11,016
Cost of services and other	23,759	25,751	48,333	50,656
Total cost of revenue	86,995	83,612	172,477	163,501
Gross profit	105,200	96,579	203,339	185,946
Operating expenses				
Sales, marketing and customer success	42,961	39,408	85,201	75,017
Research and development	22,870	22,748	45,576	45,463
General and administrative	21,882	20,091	43,805	39,770
Amortization	739	708	1,430	1,460
Total operating expenses	88,452	82,955	176,012	161,710
Income from operations	16,748	13,624	27,327	24,236
Interest expense	(3,216)	(2,721)	(5,593)	(5,396)
Other income (expense), net	827	(65)	1,113	(170)
Income before provision for income taxes	14,359	10,838	22,847	18,670
Income tax provision	3,194	1,778	171	3,373
Net income	$11,165	$9,060	$22,676	$15,297
Earnings per share				
Basic	$0.24	$0.20	$0.49	$0.33
Diluted	$0.23	$0.19	$0.48	$0.32
Common shares and equivalents outstanding				
Basic weighted average shares	46,662,481	46,083,055	46,584,263	46,047,788
Diluted weighted average shares	47,691,340	47,263,844	47,586,893	47,184,926
Dividends per share	$0.12	$0.12	$0.24	$0.24
Other comprehensive (loss) income				
Foreign currency translation adjustment	(379)	(431)	(279)	(28)
Unrealized (loss) gain on derivative instruments, net of tax	(4)	(118)	178	(787)
Total other comprehensive loss	(383)	(549)	(101)	(815)
Comprehensive income	$10,782	$8,511	$22,575	$14,482

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

Blackbaud, Inc.
Consolidated statements of cash flows
(Unaudited)

	Six months ended June 30,	
(dollars in thousands)	2017	2016
Cash flows from operating activities		
Net income	$22,676	$15,297
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36,481	35,549
Provision for doubtful accounts and sales returns	5,469	2,264
Stock-based compensation expense	20,129	16,187
Deferred taxes	(1,239)	(287)
Amortization of deferred financing costs and discount	468	478
Other non-cash adjustments	(540)	(429)
Changes in operating assets and liabilities, net of acquisition and disposal of businesses:		
Accounts receivable	(44,887)	(30,097)
Prepaid expenses and other assets	(2,501)	(6,011)
Trade accounts payable	(3,951)	8,857
Accrued expenses and other liabilities	(8,467)	(12,713)
Restricted cash due to customers	64,288	62,038
Due to customers	(64,288)	(62,038)
Deferred revenue	30,913	19,658
Net cash provided by operating activities	54,551	48,753
Cash flows from investing activities		
Purchase of property and equipment	(5,666)	(12,569)
Capitalized software development costs	(13,614)	(12,168)
Purchase of net assets of acquired companies, net of cash	(49,729)	530
Purchase of derivative instruments	(516)	—
Net cash used in investing activities	(69,525)	(24,207)
Cash flows from financing activities		
Proceeds from issuance of debt	575,700	120,900
Payments on debt	(529,169)	(126,088)
Debt issuance costs	(3,085)	—
Employee taxes paid for withheld shares upon equity award settlement	(16,644)	(8,037)
Proceeds from exercise of stock options	14	5
Dividend payments to stockholders	(11,530)	(11,398)
Net cash provided by (used in) financing activities	15,286	(24,618)
Effect of exchange rate on cash and cash equivalents	54	(27)
Net increase (decrease) in cash and cash equivalents	366	(99)
Cash and cash equivalents, beginning of period	16,902	15,362
Cash and cash equivalents, end of period	$17,268	$15,263

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

Blackbaud, Inc.
Consolidated statement of stockholders' equity
(Unaudited)

(dollars in thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Treasury stock	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
Balance at December 31, 2016	57,672,401	$ 58	$ 310,452	$ (215,237)	$ (457)	$ 152,729	$ 247,545
Net income	—	—	—	—	—	22,676	22,676
Payment of dividends	—	—	—	—	—	(11,530)	(11,530)
Exercise of stock options and stock appreciation rights and vesting of restricted stock units	311,520	—	14	—	—	—	14
Employee taxes paid for 230,967 withheld shares upon equity award settlement	—	—	—	(16,644)	—	—	(16,644)
Stock-based compensation	—	—	20,093	—	—	36	20,129
Restricted stock grants	527,160	—	—	—	—	—	—
Restricted stock cancellations	(55,015)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	(101)	—	(101)
Balance at June 30, 2017	58,456,066	$ 58	$ 330,559	$ (231,881)	$ (558)	$ 163,911	$ 262,089

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

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Blackbaud, Inc.
Notes to consolidated financial statements
(Unaudited)

1. Organization

We are the world's leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, corporations, education institutions, healthcare institutions and individual change agents—we connect and empower organizations to increase their impact through software, services, expertise, and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and CRM, marketing, advocacy, peer-to-peer fundraising, corporate social responsibility, school management, ticketing, grantmaking, financial management, payment processing, and analytics. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada and the United Kingdom. As of June 30, 2017, we had approximately 35,000 customers.

2. Basis of Presentation

Unaudited interim consolidated financial statements

The accompanying interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial reporting. These consolidated statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to state fairly the consolidated balance sheets, consolidated statements of comprehensive income, consolidated statements of cash flows and consolidated statements of stockholders' equity, for the periods presented in accordance with accounting principles generally accepted in the United States ("GAAP"). The consolidated balance sheet at December 31, 2016, has been derived from the audited consolidated financial statements at that date. Operating results and cash flows for the six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2017, or any other future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the rules and regulations for interim reporting of the SEC. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016, and other forms filed with the SEC from time to time.

Reclassifications

Due to the insignificance of our revenue from "license fees and other," we have combined that revenue with our "services" revenue beginning in 2017. In order to provide comparability between periods presented, "services" and "license fees and other" have been combined within "services and other" in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period. Similarly, "cost of services" and "cost of license fees and other" have been combined within "cost of services and other" in the previously reported consolidated statements of comprehensive income to conform to presentation of the current period.

Basis of consolidation

The consolidated financial statements include the accounts of Blackbaud, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Recently adopted accounting pronouncements

As previously disclosed, during the three months ended September 30, 2016, we early adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-09, Compensation - Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), which addresses, among other items, the accounting for income taxes and forfeitures, and cash flow presentation of share-based compensation. The early adoption of ASU 2016-09 increased net income for both the three months ended March 31, 2016 and June 30, 2016, and increased net cash provided by operating activities and net cash used in financing activities

Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

for the three months ended March 31, 2016 and June 30, 2016. Detailed information regarding the impact of our adoption of ASU 2016-09 can be found in our annual report on Form 10-K for the year ended December 31, 2016.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718) - Scope of Modification Accounting ("ASU 2017-09"), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. Under ASU 2017-09, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. ASU 2017-09 is effective for all companies for annual and interim periods beginning after December 15, 2017, with early adoption permitted in any interim period for reporting periods for which financial statements have not been issued. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date. We adopted ASU 2017-09 as of April 1, 2017. As this standard is prospective in nature, the impact to our financial statements will depend on the nature of our future award modifications.

Recently issued accounting pronouncements

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805) Clarifying the Definition of a Business ("ASU 2017-01"), which provides a screen to determine when an integrated set of assets and activities is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. ASU 2017-01 is effective for annual and interim periods beginning after December 15, 2017, with early adoption permitted, and applied prospectively. We do not expect ASU 2017-01 to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment ("ASU 2017-04"), which removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for annual and interim periods beginning after December 15, 2019, with early adoption permitted, and applied prospectively. We do not expect ASU 2017-04 to have a material impact on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) - Restricted Cash ("ASU 2016-18"), which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted, including adoption in an interim period, but any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The new standard must be adopted retrospectively. We are currently evaluating the impact of this standard on our consolidated statements of cash flows.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (ASU 2016-02). ASU 2016-02 will require lessees to record most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current guidance. The updated guidance also eliminates certain real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. For lessors, the standard modifies the classification criteria and the accounting for sales-type and direct financing leases. All entities will classify leases to determine how to recognize lease-related revenue and expense. Classification will continue to affect amounts that lessors record on the balance sheet. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted. Upon adoption, entities will be required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The modified retrospective approach

includes a number of optional practical expedients that entities may elect to apply. We expect ASU 2016-02 will impact our consolidated financial statements and are currently evaluating the extent of the impact that implementation of this standard will have on adoption.
In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09). ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The standard also provides guidance on the recognition of costs related to obtaining customer contracts. ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. ASU 2014-09 will be effective for us beginning in the first quarter of 2018. We are currently evaluating the transition methods and the impact that the adoption of ASU

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

2014-09 will have on our consolidated financial statements and related disclosures. As a result of our evaluation to date, we expect that ASU 2014-09 will generally result in the deferral of more costs to obtain a contract over a longer period using the expected period of benefit as compared with our current practice of using our average initial contract term. In addition, we expect changes in the allocation of the transaction price for contracts where we sell perpetual software licenses as ASU 2014-09 requires that the transaction price in a contract be allocated based on relative standalone selling prices of the separate performance obligations. We also anticipate incremental disclosures, including, but not limited to, quantitative reconciliations of opening and closing balances of contract assets and liabilities, the value of remaining performance obligations at the end of each reporting period, and possibly, additional disaggregation of revenue.

3. Business Combinations

JustGiving acquisition

On June 23, 2017, Blackbaud Global Limited (“Blackbaud Global”), a United Kingdom limited liability company and wholly-owned subsidiary of ours, entered into a sale and purchase agreement to acquire all of the outstanding shares of capital stock, including all voting equity interests, of Giving Limited, a United Kingdom private limited company doing business as “JustGiving” for an aggregate purchase price of £95.0 million in cash, subject to certain adjustments. JustGiving is a market leading social platform for giving, and the acquisition is expected to enhance our capabilities to serve both individual donors and nonprofits, expanding the peer-to-peer fundraising capabilities we offer today. The acquisition of JustGiving is subject to the satisfaction of certain closing conditions as set forth in the sale and purchase agreement, including the approval of the acquisition by the Competition and Markets Authority in the United Kingdom. The Company anticipates that the acquisition will close later in 2017 and will be financed with cash on hand and borrowings under our existing credit facility.

AcademicWorks acquisition

On April 3, 2017, we acquired all of the outstanding shares of capital stock, including all voting equity interests, of AcademicWorks, Inc., a Texas corporation ("AcademicWorks"), pursuant to a stock purchase agreement. AcademicWorks is the market leader in scholarship management for higher education and K-12 institutions, foundations, and grant-making institutions. The acquisition extends our offerings for our higher education, K-12, and corporate and foundation customers. We acquired AcademicWorks for $52.1 million in cash, net of closing adjustments. We financed the acquisition through a draw down of a revolving credit loan under our then-existing credit facility. As a result of the acquisition, AcademicWorks has become a wholly-owned subsidiary of ours. The operating results of AcademicWorks have been included in our consolidated financial statements within our EMG and GMG reportable segments (as defined in Note 14 below) from the date of acquisition. During the three and six months ended June 30, 2017, we incurred insignificant acquisition-related expenses associated with the acquisition of AcademicWorks, which were recorded in general and administrative expense.

The fair values assigned to the assets acquired and liabilities assumed in the table below are based on our best estimates and assumptions as of the reporting date and are considered preliminary pending finalization. The estimates and assumptions are subject to change as we obtain additional information during the measurement period, which may be up to one year from the acquisition date. The assets and liabilities, pending finalization, include the valuation of acquired finite-lived intangible assets as well as the assumed deferred revenue and deferred income tax balances.

(in thousands)	Purchase price allocation
Net working capital, excluding deferred revenue	$ 2,949
Property and equipment	290
Finite-lived intangible assets	30,900

Deferred revenue	(3,950)
Deferred tax liability	(12,350)
Goodwill	34,305
Total purchase price	$ 52,144

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

The estimated fair value of accounts receivable acquired approximates the contractual value of $1.0 million. The estimated goodwill recognized is attributable primarily to the opportunities for expected synergies from combining operations and the assembled workforce of AcademicWorks, with $20.6 million and $13.7 million assigned to our EMG and GMG reportable segments, respectively. None of the goodwill arising in the acquisition is deductible for income tax purposes.

The AcademicWorks acquisition resulted in the identification of the following identifiable finite-lived intangible assets:

AcademicWorks	Intangible assets acquired (in thousands)	Weighted average amortization period (in years)
Acquired technology	$ 22,500	9
Customer relationships	8,000	15
Marketing assets	320	2
Non-compete agreements	80	3
Total intangible assets	$ 30,900	10

The estimated fair values of the finite-lived intangible assets were based on variations of the income approach, which estimates fair value based upon the present value of cash flows that the assets are expected to generate, and which included the relief-from-royalty method, incremental cash flow method, including the comparative (with and without) method and multi-period excess earnings method, depending on the intangible asset being valued. The method of amortization of identifiable finite-lived intangible assets is based on the expected pattern in which the estimated economic benefits of the respective assets are consumed or otherwise used up. Customer relationships and acquired technology are being amortized on an accelerated basis. Marketing assets and non-compete agreements are being amortized on a straight-line basis.

We determined that the impact of this acquisition was not material to our consolidated financial statements; therefore, revenue and earnings since the acquisition date and pro forma information are not required or presented.

4. Goodwill and Other Intangible Assets

The change in goodwill for each reportable segment (as defined in Note 14 below) during the six months ended June 30, 2017, consisted of the following:

(dollars in thousands)	EMG	GMG	IMG	Total
Balance at December 31, 2016	$241,334	$192,238	$4,668	$438,240
Additions related to current year business combination[1]	20,584	13,722	—	34,306
Adjustments related to prior year business combination[2]	(29)	(58)	(1)	(88)
Effect of foreign currency translation	—	—	185	185
Balance at June 30, 2017	$261,889	$205,902	$4,852	$472,643

(1) See Note 3 to these consolidated financial statements for details regarding our acquisition of AcademicWorks.

(2) The change in goodwill was related to a post-closing working capital adjustment associated with the prior year acquisition of Good+Geek, Inc. ("Attentive.ly"), as well as an immaterial measurement period adjustment.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

5. Earnings Per Share

We compute basic earnings per share by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Diluted earnings per share reflect the assumed exercise, settlement and vesting of all dilutive securities using the “treasury stock method” except when the effect is anti-dilutive. Potentially dilutive securities consist of shares issuable upon the exercise of stock options, settlement of stock appreciation rights and vesting of restricted stock awards and units.

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands, except per share amounts)	2017	2016	2017	2016
Numerator:				
Net income	$11,165	$ 9,060	$22,676	$ 15,297
Denominator:				
Weighted average common shares	46,662,481	46,083,055	46,584,266	46,047,788
Add effect of dilutive securities:				
Stock-based awards	1,028,859	1,180,789	1,002,631	1,137,138
Weighted average common shares assuming dilution	47,691,340	47,263,844	47,586,897	47,184,926
Earnings per share:				
Basic	$0.24	$ 0.20	$0.49	$ 0.33
Diluted	$0.23	$ 0.19	$0.48	$ 0.32
Anti-dilutive shares excluded from calculations of diluted earnings per share	—	—	5,515	44,134

6. Fair Value Measurements

We use a three-tier fair value hierarchy to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

- Level 1 - Quoted prices for identical assets or liabilities in active markets;
- Level 2 - Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and
- Level 3 - Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

Recurring fair value measurements

Financial assets and liabilities measured at fair value on a recurring basis consisted of the following, as of:

(dollars in thousands)	Fair value measurement using Level 1	Level 2	Level 3	Total
Fair value as of June 30, 2017				
Financial assets:				
Derivative instruments(1)(2)	$ —	$ 1,328	$ —	$ 1,328
Total financial assets	$ —	$ 1,328	$ —	$ 1,328
Fair value as of December 31, 2016				
Financial assets:				
Derivative instruments(1)	$ —	$ 206	$ —	$ 206
Total financial assets	$ —	$ 206	$ —	$ 206
Fair value as of December 31, 2016				
Financial liabilities:				
Derivative instruments(1)	$ —	$ 163	$ —	$ 163
Total financial liabilities	$ —	$ 163	$ —	$ 163

(1) The fair value of our interest rate swaps was based on model-driven valuations using LIBOR rates, which are observable at commonly quoted intervals. Accordingly, our interest rate swaps are classified within Level 2 of the fair value hierarchy.

(2) Our foreign currency option contract is valued using a market approach based on observable quoted market prices including current spot rates and market implied volatilities. Accordingly, our foreign currency option contract is classified within Level 2 of the fair value hierarchy.

We believe the carrying amounts of our cash and cash equivalents, restricted cash due to customers, accounts receivable, trade accounts payable, accrued expenses and other current liabilities and due to customers approximate their fair values at June 30, 2017 and December 31, 2016, due to the immediate or short-term maturity of these instruments.

We believe the carrying amount of our debt approximates its fair value at June 30, 2017 and December 31, 2016, as the debt bears interest rates that approximate market value. As LIBOR rates are observable at commonly quoted intervals, our debt is classified within Level 2 of the fair value hierarchy.

We did not transfer any assets or liabilities among the levels within the fair value hierarchy during the six months ended June 30, 2017. Additionally, we did not hold any Level 3 assets or liabilities during the six months ended June 30, 2017.

Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets and goodwill, which are recognized at fair value during the period in which an acquisition is completed, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired, are based on Level 3 unobservable inputs. In the event of an impairment, we determine the fair value of the goodwill and intangible assets using a discounted cash flow approach, which contains significant unobservable inputs and, therefore, is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

There were no non-recurring fair value adjustments to intangible assets and goodwill during the six months ended June 30, 2017, except for an insignificant business combination accounting adjustment to the initial fair value estimates of the Attentive.ly assets acquired and liabilities assumed at the acquisition date from updated information obtained during the measurement period. See Note 4 to these consolidated financial statements for additional details. The measurement period of a business combination may be up to one year from the acquisition date. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

7. Consolidated Financial Statement Details

Accrued expenses and other liabilities

(dollars in thousands)	June 30, 2017	December 31, 2016
Accrued bonuses	$12,021	$ 19,217
Accrued commissions and salaries	7,646	9,352
Lease incentive obligations	5,038	5,604
Customer credit balances	5,130	5,148
Deferred rent liabilities	4,302	4,110
Taxes payable	2,630	3,452
Unrecognized tax benefit	3,452	3,295
Accrued subscriptions	3,959	2,840
Accrued vacation costs	2,598	2,214
Accrued health care costs	2,822	1,495
Other liabilities	4,482	6,002
Total accrued expenses and other liabilities	54,080	62,729
Less: Long-term portion	7,572	8,533
Accrued expenses and other current liabilities	$46,508	$ 54,196

Other income (expense), net

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2017	2016	2017	2016
Components of Other Income (Expense), Net				
Interest income	$210	$118	$378	$239
Gain on derivative instrument	475	—	475	—
Loss on debt extinguishment	(162)	—	(162)	—
Other income (expense), net	304	(183)	422	(409)
Other income (expense), net	$827	$(65)	$1,113	$(170)

8. Debt

The following table summarizes our debt balances and the related weighted average effective interest rates, which includes the effect of interest rate swap agreements.

	Debt balance at		Weighted average effective interest rate at	
(dollars in thousands)	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
Credit facility:				
Revolving credit loans	$90,400	$ 180,900	2.93 %	2.36 %
Term loans	300,000	162,969	2.35 %	2.62 %
Total debt	390,400	343,869	2.48 %	2.48 %
Less: Unamortized discount and debt issuance costs	2,738	1,476		
Less: Debt, current portion	7,500	4,375	2.48 %	2.50 %
Debt, net of current portion	$380,162	$ 338,018	2.48 %	2.48 %

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

Financing for AcademicWorks acquisition

As discussed in Note 3 to these consolidated financial statements, on April 3, 2017 we acquired AcademicWorks for $52.1 million in cash, net of closing adjustments. We financed the acquisition through a draw down of a revolving credit loan under the 2014 Credit Facility (defined below).

2017 refinancing

We were previously party to a $325.0 million five-year credit facility entered into during February 2014. The credit facility included: a dollar and a designated currency revolving credit facility with sublimits for letters of credit and swingline loans (the “2014 Revolving Facility”) and a term loan facility (the “2014 Term Loan”), together, (the “2014 Credit Facility”).

In June 2017, we entered into a five-year $700.0 million senior credit facility (the “2017 Credit Facility”). The 2017 Credit Facility includes a $400.0 million revolving credit facility (the “2017 Revolving Facility”) and a $300.0 million term loan facility (the “2017 Term Loan”). Upon closing we drew $300.0 million on a term loan and $110.0 million in revolving credit loans, which was used to repay all amounts outstanding under the 2014 Credit Facility, fees and expenses incurred in connection with the 2017 Credit Facility, and for other general corporate purposes.

Certain lenders of the 2014 Term Loan participated in the 2017 Term Loan and the change in the present value of our future cash flows to these lenders under the 2014 Term Loan and under the 2017 Term Loan was less than 10%. Accordingly, we accounted for the refinancing event for these lenders as a debt modification. Certain lenders of the 2014 Term Loan did not participate in the 2017 Term Loan. Accordingly, we accounted for the refinancing event for these lenders as a debt extinguishment. Certain lenders of the 2014 Revolving Facility participated in the 2017 Revolving Facility and provided increased borrowing capacities. Accordingly, we accounted for the refinancing event for these lenders as a debt modification. Certain lenders of the 2014 Revolving Facility did not participate in the 2017 Revolving Facility. Accordingly, we accounted for the refinancing event for these lenders as a debt extinguishment. We recorded an insignificant loss on debt extinguishment related to the write-off of debt discount and deferred financing costs for the portions of the 2014 Credit Facility considered to be extinguished. This loss was recognized in the consolidated statements of comprehensive income within other income (expense), net.

In connection with our entry into the 2017 Credit Facility, we paid $3.1 million in financing costs, of which $1.0 million was capitalized in other assets and, together with a portion of the unamortized deferred financing costs from the 2014 Credit Facility and prior facilities, are being amortized into interest expense ratably over the term of the new facility. As of June 30, 2017 and December 31, 2016, deferred financing costs totaling $1.4 million and $0.6 million, respectively, were included in other assets on our consolidated balance sheets. We recorded aggregate financing costs of $1.8 million as a direct deduction from the carrying amount of our debt liability, which related to debt discount (fees paid to lenders) and debt issuance costs for the 2017 Term Loan.

Summary of the 2017 Credit Facility

The 2017 Revolving Facility includes (i) a $50.0 million sublimit available for the issuance of standby letters of credit, (ii) a $50.0 million sublimit available for swingline loans, and (iii) a $100.0 million sublimit available for multicurrency borrowings.

The 2017 Credit Facility is secured by the stock and limited liability company interests of certain of our subsidiaries and any of our material domestic subsidiaries.

Amounts borrowed under the dollar tranche revolving credit loans and term loan under the 2017 Credit Facility bear interest at a rate per annum equal to, at our option, (a) a base rate equal to the highest of (i) the prime rate announced by Bank of America, N.A., (ii) the Federal Funds Rate plus 0.50% and (iii) the Eurocurrency Rate (which varies depending on the currency in which the loan is denominated) plus 1.00% (the “Base Rate”), in addition to a margin of 0.00% to 0.75%, or (b) Eurocurrency Rate plus a margin of 1.00% to 1.75%.

We also pay a quarterly commitment fee on the unused portion of the 2017 Revolving Facility from 0.15% to 0.25% per annum, depending on our net leverage ratio. At June 30, 2017, the commitment fee was 0.20%.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
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The term loan under the 2017 Credit Facility requires periodic principal payments. The balance of the term loan and any amounts drawn on the revolving credit loans are due upon maturity of the 2017 Credit Facility in June 2022. We evaluate the classification of our debt as current or non-current based on the required annual maturities of the 2017 Credit Facility.

The 2017 Credit Facility includes financial covenants related to the net leverage ratio and interest coverage ratio, as well as restrictions on our ability to declare and pay dividends and our ability to repurchase shares of our common stock. At June 30, 2017, we were in compliance with our debt covenants under the 2017 Credit Facility.

The 2017 Credit Facility also includes an option to request increases in the revolving commitments and/or request additional term loans in an aggregate principal amount of up to $200.0 million plus an amount, if any, such that the Net Leverage Ratio shall be no greater than 3.00 to 1.00.

As of June 30, 2017, the required annual maturities related to the 2017 Credit Facility were as follows:

Years ending December 31, (dollars in thousands)	Annual maturities
2017 - remaining	$ 3,750
2018	7,500
2019	7,500
2020	7,500
2021	7,500
Thereafter	356,650
Total required maturities	$ 390,400

9. Derivative Instruments

Cash flow hedges

We generally use derivative instruments to manage our variable interest rate risk. In March 2014, we entered into an interest rate swap agreement (the "March 2014 Swap Agreement"), which effectively converts portions of our variable rate debt under our credit facility to a fixed rate for the term of the swap agreement. The initial notional value of the March 2014 Swap Agreement was $125.0 million with an effective date beginning in March 2014. In March 2017, the notional value of the March 2014 Swap Agreement decreased to $75.0 million for the remaining term through February 2018. We designated the March 2014 Swap Agreement as a cash flow hedge at the inception of the contract.

In October 2015, we entered into an additional interest rate swap agreement (the "October 2015 Swap Agreement"), which effectively converts portions of our variable rate debt under our credit facility to a fixed rate for the term of the October 2015 Swap Agreement. The notional value of the October 2015 Swap Agreement was $75.0 million with an effective date beginning in October 2015 and maturing in February 2018. We designated the October 2015 Swap Agreement as a cash flow hedge at the inception of the contract.

Undesignated contracts

In June 2017, we entered into a foreign currency option contract to hedge our exposure to currency fluctuations in connection with our anticipated acquisition of JustGiving, which is expected to close later in 2017, because the purchase price is denominated in British Pounds. The notional value of the instrument is £100.0 million with an effective date beginning in June 2017 and maturing in September 2017. We did not designate this foreign currency option contract as a cash flow hedge for accounting purposes since it involves a business combination. As such, changes in the fair value of this derivative are recognized currently in earnings. The insignificant premium paid for this option is shown within cash flows from investing activities in our consolidated statements of cash flows.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

The fair values of our derivative instruments were as follows as of:

		Asset Derivatives			Liability Derivatives	
(dollars in thousands)	Balance sheet location	June 30, 2017	December 31, 2016	Balance sheet location	June 30, 2017	December 31, 2016
Derivative instruments designated as hedging instruments:						
Interest rate swaps, current portion	Prepaid expenses and other current assets	$336	$ —	Accrued expenses and other current liabilities	$ —	$ —
Interest rate swaps, long-term portion	Other assets	—	206	Other liabilities	—	163
Total derivative instruments designated as hedging instruments		$336	$ 206		$ —	$ 163
Derivative instruments not designated as hedging instruments:						
Foreign currency option contracts	Prepaid expenses and other current assets	$992	$ —	Accrued expenses and other current liabilities	$ —	$ —
Total derivative instruments not designated as hedging instruments		$992	$ —		$ —	$ —
Total derivative instruments		$1,328	$ 206		$ —	$ 163

The effects of derivative instruments in cash flow hedging relationships were as follows:

	Gain (loss) recognized in accumulated other comprehensive loss as of	Location of gain (loss) reclassified from accumulated other comprehensive loss into income	Gain (loss) reclassified from accumulated other comprehensive loss into income	
(dollars in thousands)	June 30, 2017		Three months ended June 30, 2017	Six months ended June 30, 2017
Interest rate swaps	$ 336	Interest expense	$ 15	$ (104)
	June 30, 2016		Three months	Six months

			ended June 30, 2016	ended June 30, 2016
Interest rate swaps	$ (1,329)	Interest expense	$ (302)	$ (610)

Our policy requires that derivatives used for hedging purposes be designated and effective as a hedge of the identified risk exposure at the inception of the contract. Accumulated other comprehensive income (loss) includes unrealized gains or losses from the change in fair value measurement of our derivative instruments each reporting period and the related income tax expense or benefit. Changes in the fair value measurements of the derivative instruments and the related income tax expense or benefit are reflected as adjustments to accumulated other comprehensive income (loss) until the actual hedged expense is incurred or until the hedge is terminated at which point the unrealized gain (loss) is reclassified from accumulated other comprehensive income (loss) to current earnings. The estimated accumulated other comprehensive income as of June 30, 2017 that is expected to be reclassified into earnings within the next twelve months is insignificant. There were no ineffective portions of our interest rate swap derivatives during the six months ended June 30, 2017 and 2016. See Note 13 to these consolidated financial statements for a summary of the changes in accumulated other comprehensive income (loss) by component.

We did not have any undesignated derivative instruments during 2016. The effects of undesignated derivative instruments during the three and six months ended June 30, 2017 were as follows:

(dollars in thousands)	Location of gain (loss) recognized in income on derivative	Gain (loss) recognized in income	
		Three months ended June 30, 2017	Six months ended June 30, 2017
Foreign currency option contracts	Other income (expense), net	$475	$ 475

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

10. Commitments and Contingencies

Leases

Total rent expense was $4.1 million and $3.5 million for the three months ended June 30, 2017 and 2016, respectively, and $8.1 million and $5.5 million for the six months ended June 30, 2017 and 2016, respectively. The quarterly South Carolina state incentive payments we received as a result of locating our headquarters facility in Berkeley County, South Carolina, ended in the fourth quarter of 2016. These amounts were recorded as a reduction of rent expense upon receipt and were $0.7 million and $1.6 million during the three and six months ended June 30, 2016, respectively.

Other commitments

The term loans under the 2017 Credit Facility require periodic principal payments. The balance of the term loans and any amounts drawn on the revolving credit loans are due upon maturity of the 2017 Credit Facility in June 2022.

We have contractual obligations for third-party technology used in our solutions and for other services we purchase as part of our normal operations. In certain cases, these arrangements require a minimum annual purchase commitment by us. As of June 30, 2017, the remaining aggregate minimum purchase commitment under these arrangements was approximately $55.5 million through 2021.

Solution and service indemnifications

In the ordinary course of business, we provide certain indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our solutions or services. If we determine that it is probable that a loss has been incurred related to solution or service indemnifications, any such loss that could be reasonably estimated would be recognized. We have not identified any losses and, accordingly, we have not recorded a liability related to these indemnifications.

Legal proceedings

We are subject to legal proceedings and claims that arise in the ordinary course of business. We make a provision for a loss contingency when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined as of June 30, 2017, that no provision for liability nor disclosure is required related to any claim against us because (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, results of operations or cash flows could be negatively affected in any particular period by an unfavorable resolution of one or more of such proceedings, claims or investigations.

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

11. Income Taxes

Our income tax provision and effective income tax rates, including the effects of period-specific events, were:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2017	2016[(1)]	2017	2016[(1)]
Income tax provision	$3,194	$1,778	$171	$3,373
Effective income tax rate	22.2 %	16.4 %	0.7 %	18.1 %

(1) As discussed in Note 2 to these consolidated financial statements, we early adopted ASU 2016-09 relating to stock-based compensation during the three months ended September 30, 2016. Under ASU 2016-09, tax benefits in excess of compensation costs (windfalls) generated upon the exercise or settlement of stock awards are no longer recognized as additional paid-in capital but are instead recognized as a reduction to income tax expense. This change in accounting for income taxes was effective for us on a prospective basis as of the beginning of the 2016 fiscal year.

The increase in our effective income tax rate during the three months ended June 30, 2017, when compared to the same period in 2016, was primarily due to a larger amount of income before taxes during the three months ended June 30, 2017, which reduced the impact of the discrete tax benefit to expense relating to stock-based compensation items. The decrease in our effective income tax rate during the six months ended June 30, 2017, when compared to the same period in 2016, was primarily due to a $7.3 million discrete tax benefit to expense relating to stock-based compensation items, as compared to a $2.7 million discrete tax benefit for the same period in 2016. The increase in the discrete tax benefit for the six months ended June 30, 2017, as compared to the same period in 2016, was attributable to an increase in the market price for shares of our common stock, as reported by the NASDAQ Stock Market LLC ("NASDAQ"), as well as an increase in the number of stock awards that vested and were exercised. Most of our equity awards are granted during our first quarter and vest in subsequent years during the same quarter.

12. Stock-based Compensation

Stock-based compensation expense is allocated to cost of revenue and operating expenses on the consolidated statements of comprehensive income based on where the associated employee’s compensation is recorded. The following table summarizes stock-based compensation expense:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2017	2016	2017	2016
Included in cost of revenue:				
Cost of subscriptions	$338	$311	$632	$586
Cost of maintenance	105	136	191	254
Cost of services and other	507	395	918	847
Total included in cost of revenue	950	842	1,741	1,687
Included in operating expenses:				
Sales, marketing and customer success	1,781	1,021	3,220	1,917
Research and development	2,067	1,729	3,784	3,200
General and administrative	6,037	4,852	11,384	9,383
Total included in operating expenses	9,885	7,602	18,388	14,500
Total stock-based compensation expense	$10,835	$8,444	$20,129	$16,187

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

13. Stockholders' Equity

Dividends

Our Board of Directors has adopted a dividend policy, which provides for the distribution to stockholders of a portion of cash generated by us that is in excess of operational needs and capital expenditures. The 2017 Credit Facility limits the amount of dividends payable and certain state laws restrict the amount of dividends distributed.

In February 2017, our Board of Directors approved an annual dividend rate of $0.48 per share to be made in quarterly payments. Dividend payments are not guaranteed and our Board of Directors may decide, in its absolute discretion, at any time and for any reason, not to declare and pay further dividends. The following table provides information with respect to quarterly dividends of $0.12 per share paid on common stock during the six months ended June 30, 2017.

Declaration Date	Dividend per Share	Record Date	Payable Date
February 8, 2017	$ 0.12	February 28	March 15
May 1, 2017	$ 0.12	May 26	June 15

On July 31, 2017, our Board of Directors declared a third quarter dividend of $0.12 per share payable on September 15, 2017 to stockholders of record on August 28, 2017.

Changes in accumulated other comprehensive loss by component

The changes in accumulated other comprehensive loss by component, consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2017	2016	2017	2016
Accumulated other comprehensive loss, beginning of period	$(175)	$(1,091)	$(457)	$(825)
By component:				
Gains and losses on cash flow hedges:				
Accumulated other comprehensive income (loss) balance, beginning of period	$207	$(688)	$25	$(19)
Other comprehensive income (loss) before reclassifications, net of tax effects of $(3), $195, $(74) and $750	5	(301)	115	(1,157)
Amounts reclassified from accumulated other comprehensive loss to interest expense	(15)	302	104	610
Tax benefit included in provision for income taxes	6	(119)	(41)	(240)
Total amounts reclassified from accumulated other comprehensive loss	(9)	183	63	370
Net current-period other comprehensive (loss) income	(4)	(118)	178	(787)
Accumulated other comprehensive income (loss) balance, end of period	$203	$(806)	$203	$(806)
Foreign currency translation adjustment:				
Accumulated other comprehensive loss balance, beginning of period	$(382)	$(403)	$(482)	$(806)
Translation adjustments	(379)	(431)	(279)	(28)
Accumulated other comprehensive loss balance, end of period	(761)	(834)	(761)	(834)
Accumulated other comprehensive income (loss), end of period	$(558)	$(1,640)	$(558)	$(1,640)

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Blackbaud, Inc.
Notes to consolidated financial statements (continued)
(Unaudited)

14. Segment Information

During the first quarter of 2017, we changed the names of our reportable segments. However, there was no change in the determination of our reportable segments or our reporting units at that time. As of June 30, 2017, our reportable segments were the General Markets Group ("GMG"), the Emerging Markets Group ("EMG"), and the International Markets Group ("IMG"). The following is a description of each reportable segment:

- The GMG is generally focused on sales to all emerging and mid-sized prospects and customers in North America;
- The EMG is generally focused on sales to all large and/or strategic prospects and customers in North America; and
- The IMG is focused on marketing, sales, delivery and support to all prospects and customers outside of North America.

Our chief operating decision maker is our chief executive officer ("CEO"). Currently, our CEO reviews financial information presented on an operating segment basis for the purposes of making certain operating decisions and assessing financial performance. The CEO uses internal financial reports that provide segment revenues and operating income, excluding stock-based compensation expense, amortization expense, depreciation expense, research and development expense and certain corporate sales, marketing, general and administrative expenses. Currently, the CEO believes that the exclusion of these costs allows for a better understanding of the operating performance of the operating units and management of other operating expenses and cash needs. The CEO does not review any segment balance sheet information. Summarized reportable segment financial results, were as follows:

	Three months ended June 30,		Six months ended June 30,	
(dollars in thousands)	2017	2016	2017	2016
Revenue by segment:				
GMG	$99,215	$93,970	$194,116	$181,922
EMG	82,245	75,037	161,877	146,536
IMG	10,730	11,138	19,786	20,896
Other[1]	5	46	37	93
Total revenue	$192,195	$180,191	$375,816	$349,447
Segment operating income[2]:				
GMG	$47,983	$45,262	$93,687	$87,873
EMG	44,037	38,721	86,512	74,487
IMG	2,947	1,065	4,196	2,061
Other[1]	(71)	18	(55)	48
	94,896	85,066	184,340	164,469
Less:				
Corporate unallocated costs[3]	(56,502)	(52,363)	(115,527)	(102,778)
Stock-based compensation costs	(10,835)	(8,444)	(20,129)	(16,187)
Amortization expense	(10,811)	(10,635)	(21,357)	(21,268)
Interest expense	(3,216)	(2,721)	(5,593)	(5,396)
Other income (expense), net	827	(65)	1,113	(170)
Income before provision for income taxes	$14,359	$10,838	$22,847	$18,670

(1) Other includes revenue and the related costs from the sale of solutions and services not directly attributable to a reportable segment.

(2) Segment operating income includes direct, controllable costs related to the sale of solutions and services by the reportable segment.

(3) Corporate unallocated costs include research and development, depreciation expense, and certain corporate sales, marketing, general and administrative expenses.

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In light of the ongoing and anticipated increasing centralization of our operations, including without limitation marketing, customer support, customer success and professional services, we are evaluating whether changes may need to be made to our internal reporting structure to better support and assess the operations of our business going forward. If changes are made, we will assess the resulting effect on our reportable segments, operating segments and reporting units, if any.

15. Subsequent Events

Entry into interest rate swap agreement

In July 2017, we entered into an additional interest rate swap agreement (the "July 2017 Swap Agreement"), which effectively converts portions of our variable rate debt under our credit facility to a fixed rate for the term of the swap agreement. The notional value of the July 2017 Swap Agreement was $150.0 million with an effective date beginning in July 2017 through July 2021. We designated the July 2017 Swap Agreement as a cash flow hedge at the inception of the contract. See Note 9 to these consolidated financial statements for information on our other interest rate swap agreements.

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Blackbaud, Inc.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis presents financial information denominated in millions of dollars which can lead to differences from rounding when compared to similar information contained in the consolidated financial statements and related notes which are primarily denominated in thousands of dollars.

Executive Summary

We are the world's leading cloud software company powering social good. Serving the entire social good community—nonprofits, foundations, corporations, education institutions, healthcare institutions and individual change agents—we connect and empower organizations to increase their impact through software, services, expertise, and data intelligence. Our portfolio is tailored to the unique needs of vertical markets, with solutions for fundraising and CRM, marketing, advocacy, peer-to-peer fundraising, corporate social responsibility, school management, ticketing, grantmaking, financial management, payment processing, and analytics. Serving the industry for more than three decades, we are headquartered in Charleston, South Carolina and have operations in the United States, Australia, Canada and the United Kingdom. As of June 30, 2017, we had approximately 35,000 customers.

Our revenue is primarily generated from the following sources: (i) charging for the use of our software solutions in cloud-based and hosted environments; (ii) providing transaction and payment processing services; (iii) providing software maintenance and support services; and (iv) providing professional services including implementation, training, consulting, analytic and other services.

During the second quarter of 2017, we continued to execute on our four-point growth strategy targeted to drive an extended period of quality enhancement, solution and service innovation and increasing operating efficiency and financial performance:

1. Deliver Integrated and Open Solutions in the Cloud

We continue to transition our business to predominantly serve customers through a subscription-based cloud delivery model, enabling lower cost of entry, greater scalability and lower total cost of ownership to our customers. There is a concerted effort underway to optimize our portfolio of solutions and integrate powerful capabilities — such as built in data, analytics, payment processing and tailored user-specific experiences — to bring even greater value and performance to our customers.

The Blackbaud SKY™ cloud platform is allowing us to innovate at a more rapid pace, including delivering enhanced integrated analytics capabilities that surface directly in our customers' software through SKY AI and SKY Analytics—components of our broader Intelligence for Good approach that combines AI, analytics, one of the industry's most robust data sets and expertise to drive powerful insights for our customers. These embedded, cloud-delivered insights provide high impact, workflow-integrated intelligence that drives fundraising, advocacy, event participation and other purpose driven constituent interactions. In higher education institutions, for example, we released a new athletic giving solution, designed specifically to help athletic departments raise more money through the university community and athletic program supporters.

2. Drive Sales Effectiveness

We are making investments to create a world-class sales organization to accelerate revenue growth and penetrate our large and expanding total addressable market ("TAM"), which is currently estimated to be over $7.0 billion. During the first half of 2017, we created a new Senior Vice President of Global Sales position to lead this effort across the organization.

We continue adding to our salesforce, improving market coverage by deploying sales headcount into the field, and we are focused on enabling our expanding sales teams with training, processes, and tools to improve effectiveness and drive revenue growth. The move to selling pre-integrated solution suites instead of individual point-solutions continues to be

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successful, and we have furthered our go-to-market shift with a concentrated sales focus by sub-vertical, including K-12 private schools, foundations, corporations, arts & cultural, higher education and healthcare.

3. Expand TAM into Near Adjacencies through Acquisitions and Product Investments

We continue to evaluate compelling opportunities to acquire companies, technologies and/or services. We are guided by our acquisition criteria for considering attractive assets that expand our TAM, provide entry into new and near adjacencies, accelerate our shift to the cloud, accelerate revenue growth, are accretive to margins and present synergistic opportunities.

During the first half of 2017, we announced the promotion of our new Senior Vice President of Corporate Strategy and Business Development, who led the effort for many of our recent acquisitions, including AcademicWorks in April 2017. AcademicWorks is the market leader in scholarship management for higher education and K-12 institutions, foundations, and grant-making institutions. Their cloud platform enables students to apply for all awards at an institution using one intuitive and streamlined process, while offering schools and awarding institutions a common platform for improved awarding, reporting, compliance, communication and stewardship of those awards. Additional details regarding our acquisition of AcademicWorks are provided in Note 3 to our consolidated financial statements in this report. During the second quarter, we were focused on integrating AcademicWorks' solutions and operations and began cross-selling to enable us to begin realizing anticipated synergies.

In June 2017, we announced that we have entered into an agreement to acquire the United Kingdom-based online fundraising services provider JustGiving, whose online social giving platform has played a powerful role in the growth of peer-to-peer fundraising. The acquisition will enhance our capability to serve both individual donors and nonprofits, expanding the peer-to-peer fundraising capabilities we currently offer today through TeamRaiser and everydayhero, which are used by leading nonprofit organizations to connect their causes to the individuals who support them. JustGiving will also add personal crowdfunding to our portfolio, which is an offering we do not currently provide and a fast growing segment of charitable giving. We expect the acquisition to close later in 2017 after we conclude the United Kingdom Competition and Markets Authority review and other closing conditions are satisfied.

Both AcademicWorks and JustGiving meet the acquisition criteria discussed above. We remain active in the evaluation of acquisition opportunities to broaden our portfolio, provide better integrated solutions for our customers, differentiate ourselves from the competition and improve our financial performance.

4. Improve Operating Efficiency

We are also focused on operational efficiency to deliver improved profitability. In 2014, we set a long-term aspirational goal to improve operating margins annually, and increase our non-GAAP operating margins by at least 300 basis points on a constant currency basis from our 2014 baseline of 17.5%, by the end of 2017. Since setting that goal, we have improved margins annually, inclusive of heightened investments to drive future growth and in the midst of migrating our customer base to the cloud. We expect to deliver on our goal, and we see future opportunity ahead to further improve profitability through the infrastructure investments we have made in our back office for scale, focus on operational excellence, and achieving our productivity initiatives.

We have included the results of operations of AcademicWorks in our consolidated results of operations from the date of acquisition. We determined that the AcademicWorks acquisition was not a material business combination; therefore, revenue and earnings since the acquisition date are not required or presented.

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Blackbaud, Inc.

Total revenue

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
Total revenue	$192.2	$180.2	6.7 %	$375.8	$349.4	7.5 %

The increases in total revenue during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily driven by growth in subscriptions revenue as our business model continues to shift towards providing predominantly cloud-based subscription solutions. Subscriptions revenue also grew as a result of increases in the number of customers and the volume of transactions for which we process payments. Services and other revenue as well as maintenance revenue declined during the three and six months ended June 30, 2017 from the continued migration of our business model toward subscription-based solutions. In general, our NXT and other cloud-based solutions require less implementation services, which will continue to negatively impact services and other revenue growth over time. In the near-term, the transition to subscription-based solutions also negatively impacts total revenue growth, as time-based revenue from subscription arrangements is deferred and recognized ratably over the subscription period, typically three years at contract inception, whereas on-premises license revenue from arrangements that include perpetual licenses is recognized up-front. In addition, the fluctuation in foreign currency exchange rates, primarily those between the U.S. dollar and British pound, negatively impacted our total revenue three and six months ended June 30, 2017 by $1.1 million and $1.3 million, respectively. Further explanation of this impact is included below under the caption "Foreign Currency Exchange Rates".

Income from operations

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
Income from operations	$16.7	$13.6	22.9 %	$27.3	$24.2	12.8 %

Income from operations increased during the three and six months ended June 30, 2017, when compared to the same periods in 2016. The positive impact of growth in total revenue driven by subscriptions as discussed above was partially offset primarily by investments we are making in our sales organization and customer success program and, to a lesser extent, increases in stock based compensation expense of $2.4 million and $3.9 million, respectively, rent expense of $0.6 million and $2.6 million, respectively, and acquisition-related deal and integration costs of $1.6 million and $1.9 million. An increase of $2.5 million in employee severance costs during the six months ended June 30, 2017 also negatively impacted income from operations. The increase in rent expense was primarily driven by the end in the fourth quarter of 2016 of the South Carolina state incentive payments we received as a result of locating our headquarters facility in Berkeley County, South Carolina. These amounts were recorded as a reduction of rent expense upon receipt. Also contributing to the increase in rent expense were new operating leases for equipment that we have historically purchased.

Customer retention

Subscription contracts are typically for a term of three years at contract inception with one year renewals thereafter. Over time, we anticipate a decrease in maintenance contract renewals as we transition our solution portfolio and maintenance customers from a perpetual license-based model to a cloud-based subscription delivery model. We also anticipate an increase in subscription contract renewals as we continue focusing on innovation, quality and the integration of our subscription solutions which we believe will provide value-adding capabilities to better address our customers' needs. Due primarily to these factors, we believe a recurring revenue customer retention measure that combines subscription and maintenance customer contracts provides an accurate representation of our customers' overall behavior. For the year ended June 30, 2017, approximately 93% of our customers with recurring subscription or maintenance contracts were retained. This customer retention rate is relatively unchanged from our rate for the full year 2016.

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Blackbaud, Inc.

Balance sheet and cash flow

At June 30, 2017, our cash and cash equivalents were $17.3 million and outstanding borrowings under the 2017 Credit Facility were $390.4 million. During the six months ended June 30, 2017, we generated $54.6 million in cash flow from operations, increased our net borrowings by $46.5 million, primarily for the acquisition of AcademicWorks, returned $11.5 million to stockholders by way of dividends and had aggregate cash outlays of $19.3 million for purchases of property and equipment and capitalized software development costs.

Recent developments

Debt refinancing

In June 2017, we entered into the 2017 Credit Facility, which includes a $400.0 million revolving credit facility and a $300.0 million term loan facility. Upon closing, we drew $300.0 million on a term loan and $110.0 million in revolving credit loans, which was used to repay all amounts outstanding under our previous credit facility and for other general corporate purposes. The 2017 Credit Facility is secured by the stock and limited liability company interests of certain of our subsidiaries and is guaranteed by our material domestic subsidiaries.

JustGiving acquisition

In June 2017, Blackbaud Global Limited (“Blackbaud Global”), a United Kingdom limited liability company and wholly-owned subsidiary of ours, entered into a sale and purchase agreement to acquire all of the outstanding shares of capital stock of Giving Limited, a United Kingdom private limited company doing business as “JustGiving” for an aggregate purchase price of £95.0 million in cash, subject to certain adjustments. JustGiving is a market leading social platform for giving and the acquisition is expected to enhance our capabilities to serve both individual donors and nonprofits, expanding the peer-to-peer fundraising capabilities we offer today. The acquisition of JustGiving is subject to the satisfaction of certain closing conditions as set forth in the sale and purchase agreement, including the approval of the acquisition by the Competition and Markets Authority in the United Kingdom. The Company anticipates that the acquisition will close later in 2017 and will be financed with cash on hand and borrowings under our existing credit facility.

Entry into interest rate swap agreement

In July 2017, we entered into the July 2017 Swap Agreement, which effectively converts portions of our variable rate debt under the 2017 Credit Facility to a fixed rate for the term of the swap agreement. The notional value of the July 2017 Swap Agreement was $150.0 million with an effective date beginning in July 2017 through July 2021. We designated the July 2017 Swap Agreement as a cash flow hedge at the inception of the contract.

Results of Operations

Comparison of the three and six months ended June 30, 2017 and 2016

Revenue by segment

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
GMG	$99.2	$94.0	5.6 %	$194.1	$181.9	6.7 %
EMG	82.2	75.0	9.6 %	161.9	146.5	10.5 %
IMG	10.7	11.1	(3.7)%	19.8	20.9	(5.3)%
Total revenue(1)	$192.2	$180.2	6.7 %	$375.8	$349.4	7.5 %

(1) The individual amounts for each year may not sum to total revenue due to rounding.

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Blackbaud, Inc.

GMG

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
GMG revenue	$99.2	$94.0	5.6 %	$194.1	$181.9	6.7 %
% of total revenue	51.6 %	52.2 %		51.7 %	52.1 %	

The increases in GMG revenue during the three and six months ended June 30, 2017 when compared to the same periods in 2016 were attributable to growth in subscriptions revenue, partially offset by declines in services and other revenue and maintenance revenue. The growth in GMG subscriptions revenue was primarily due to increases in demand across our portfolio of cloud-based solutions. To a much lesser extent, GMG subscriptions revenue growth was also driven by increases in the number of customers and the volume of transactions for which we process payments. We expect that the ongoing shift in our go-to-market strategy towards cloud-based subscription offerings, which, in general, require less implementation services will continue to negatively impact the growth of both services and other revenue and maintenance revenue over time.

EMG

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
EMG revenue	$82.2	$75.0	9.6 %	$161.9	$146.5	10.5 %
% of total revenue	42.8 %	41.6 %		43.1 %	41.9 %	

The increases in EMG revenue during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily attributable to growth in subscriptions revenue, partially offset by decreases in services and other revenue and maintenance revenue. The growth in EMG subscriptions was driven primarily by increases in demand for our cloud-based solutions, as well as an increase in the number of customers and the volume of transactions for which we process payments. We expect that the ongoing shift in our go-to-market strategy towards cloud-based subscription offerings, which, in general, require less implementation services will continue to negatively impact the growth of both services and other revenue and maintenance revenue over time.

IMG

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
IMG revenue	$10.7	$11.1	(3.7)%	$19.8	$20.9	(5.3)%
% of total revenue	5.6 %	6.2 %		5.3 %	6.0 %	

The decreases in IMG revenue during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily related to reductions in services and other revenue and maintenance revenue, partially offset by increases in subscriptions revenue. The increases in IMG subscriptions revenue during the three and six months ended June 30, 2017 were primarily due to increased demand for our cloud-based solutions and, to a lesser extent, increases in the volume of transactions for which we process payments. The fluctuation in foreign currency exchange rates negatively impacted IMG revenue during three and six months ended June 30, 2017 by approximately $0.7 million and $1.1 million, respectively. Further explanation of this impact is included below under the caption "Foreign Currency Exchange Rates".

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Blackbaud, Inc.

Operating results
Subscriptions

	Three months ended June 30,			Six months ended June 30,		
(dollars in millions)	2017	2016	Change	2017	2016	Change
Subscriptions revenue	$125.3	$104.0	20.4 %	$243.4	$200.9	21.2 %
Cost of subscriptions	57.4	52.2	10.0 %	112.3	101.8	10.3 %
Subscriptions gross profit(1)	$67.9	$51.9	30.9 %	$131.1	$99.1	32.4 %
Subscriptions gross margin	54.2 %	49.9 %		53.9 %	49.3 %	

(1) The individual amounts for each year may not sum to subscriptions gross profit due to rounding.

Subscriptions revenue is comprised of revenue from charging for the use of our subscription-based software solutions, which includes providing access to cloud-based solutions and hosting services, access to certain data services and our online subscription training offerings, revenue from payment processing services, as well as variable transaction revenue associated with the use of our solutions.

We continue to experience growth in sales of our cloud-based solutions and hosting services as we meet the demand of our customers that increasingly prefer cloud-based subscription offerings, including existing customers that are migrating from on-premises solutions to our cloud-based solutions. In addition, we have experienced growth in our payment processing services from the continued shift to online giving, further integration of these services to our existing solution portfolio and the sale of these services to new and existing customers. Recurring subscriptions contracts are typically for a term of three years at contract inception with one year renewals thereafter. We intend to continue focusing on innovation, quality and integration of our subscription solutions, which we believe will drive subscriptions revenue growth. We are also investing in our customer success organization to drive customer loyalty, retention, and referrals.

Cost of subscriptions is primarily comprised of compensation costs for customer support and production IT personnel, third-party contractor expenses, third-party royalty and data expenses, hosting expenses, allocated depreciation, facilities and IT support costs, amortization of intangible assets from business combinations, amortization of software development costs, transaction-based costs related to payments services including remittances of amounts due to third-parties and other costs incurred in providing support and services to our customers.

The increases in subscriptions revenue during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily due to strong demand across our cloud-based solution portfolio, and, to a lesser extent, increases in the number of customers and the volume of transactions for which we process payments.

The increases in cost of subscriptions during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily due to increases in transaction-based costs related to our payments services and those of Smart Tuition of $3.7 million and $7.7 million, respectively and increases in the cost of third-party technology embedded in certain of our subscription solutions of $1.6 million and $3.3 million. Partially offsetting these increases in cost of subscriptions during the three and six months ended June 30, 2017 were decreases in third-party contractor expenses of $0.7 million and $1.1 million, respectively.

The increases in subscriptions gross margin for the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily the result of the positive economics of shifting customers to our next generation cloud-based solutions as growth in subscriptions revenue outpaced the growth in related costs. The results of AcademicWorks did not significantly impact our subscriptions gross margins for the three and six months ended June 30, 2017.

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Blackbaud, Inc.

Maintenance

(dollars in millions)	Three months ended June 30, 2017	2016	Change	Six months ended June 30, 2017	2016	Change
Maintenance revenue	$32.9	$37.4	(12.1)%	$66.7	$74.6	(10.6)%
Cost of maintenance	5.9	5.7	3.0 %	11.9	11.0	7.6 %
Maintenance gross profit(1)	$27.0	$31.8	(14.8)%	$54.8	$63.6	(13.8)%
Maintenance gross margin	82.2 %	84.8 %		82.2 %	85.2 %	

(1) The individual amounts for each year may not sum to maintenance gross profit due to rounding.

Maintenance revenue is comprised of annual fees derived from maintenance contracts associated with new software licenses and annual renewals of existing maintenance contracts. These contracts provide customers with updates, enhancements and certain upgrades to our software solutions and online, telephone and email support. Maintenance contracts are typically renewed on an annual basis.

Cost of maintenance is primarily comprised of compensation costs for customer support personnel, third-party contractor expenses, third-party royalty costs, allocated depreciation, facilities and IT support costs, amortization of intangible assets from business combinations, amortization of software development costs and other costs incurred in providing support and services to our customers.

The decreases in maintenance revenue during the three and six months ended June 30, 2017, when compared to the same periods in 2016, were primarily comprised of (i) reductions in maintenance from contracts that were migrated to a cloud-based subscription or not renewed and reductions in contracts with existing customers of $9.5 million and $17.1 million, respectively; partially offset by (ii) incremental maintenance from new customers associated with new license contracts and increases in contracts with existing customers of $4.8 million and $8.8 million, respectively; and (iii) insignificant amounts of incremental maintenance from contractual inflationary rate adjustments.

Cost of maintenance during the three months ended June 30, 2017 remained relatively unchanged when compared to the same period in 2016. Cost of maintenance increased during the six months ended June 30, 2017, when compared to the same period in 2016, primarily as a result of an increase in compensation costs of $0.8 million, driven by a refinement in the method in which we allocate customer support costs between cost of maintenance and cost of subscriptions.

Maintenance gross margin decreased during the three and six months ended June 30, 2017, when compared to the same periods in 2016, primarily due to the increase in maintenance customer support costs combined with the decline in maintenance revenue as discussed above.

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Blackbaud, Inc.

Services and other

(dollars in millions)	Three months ended June 30, 2017	2016	Change	Six months ended June 30, 2017	2016	Change
Services and other revenue	$34.0	$38.7	(12.1)%	$65.7	$73.9	(11.2)%
Cost of services and other	23.8	25.8	(7.7)%	48.3	50.7	(4.6)%
Services and other gross profit[(1)]	$10.3	$13.0	(20.7)%	$17.4	$23.3	(25.5)%
Services and other gross margin	30.2 %	33.5 %		26.4 %	31.5 %	

(1) The individual amounts for each year may not sum to services and other gross profit due to rounding.

Services and other revenue includes consulting, implementation, education, analytic and installation services as well as revenue from the sale of our software sold under perpetual license arrangements, fees from user conferences and third-party software referral fees. Consulting, implementation and installation services involve converting data from a customer's existing system, system configuration, process re-engineering and assistance in file set up. Education services involve customer training activities. Analytic services are comprised of donor prospect research, sales of lists of potential donors, benchmarking studies and data modeling services. These analytic services involve the assessment of current and prospective donor information of the customer and are performed using our proprietary analytical tools. The end product is intended to enable organizations to more effectively target their fundraising activities.

Cost of services and other is primarily comprised of compensation costs for professional services and training personnel, third-party contractor expenses, costs incurred in providing customer training, data expense incurred to perform analytic services, third-party software royalties, variable reseller commissions, costs of user conferences, allocated depreciation, facilities and IT support costs and amortization of intangible assets from business combinations.

Services and other revenue decreased during the three and six months ended June 30, 2017, when compared to the same periods in 2016, primarily due to decreases in consulting revenue and, to a lesser extent, declines in analytics revenue and license fees revenue. We expect that the ongoing shift in our go-to-market strategy towards cloud-based subscription offerings, which, in general, require less implementation services, will continue to negatively impact services and other revenue growth over time. We have also used promotions and discounts as incentives to accelerate the migration of our existing customer base from on-premises solutions toward our cloud-based subscriptions. The maturation of our Blackbaud Enterprise CRM solution, our only remaining perpetual licensed-based offering, is lessening the extent of implementation services required for that solution. In addition, our perpetual license transactions for Blackbaud Enterprise CRM can be individually significant, which can result in period to period variations in revenue since the license fee revenue associated with these arrangements is generally recognized up front when the arrangements are entered into.

Cost of services and other decreased during the three and six months ended June 30, 2017, when compared to the same periods in 2016, primarily due to decreases in compensation costs of $0.7 mill