Shutterstock, Inc.
Form 10-Q
October 30, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-35669

SHUTTERSTOCK, INC.
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o 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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	
	Smaller reporting company o

Emerging growth company o

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. o

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

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

Class	Outstanding at October 26, 2018
Common Stock, $0.01 par value per share	35,036,943

Table of Contents

Shutterstock, Inc.
FORM 10-Q
Table of Contents
For the Quarterly Period Ended September 30, 2018

Table of Contents

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, particularly in the discussion under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Examples of forward-looking statements include, but are not limited to, statements regarding future business, future results of operations or financial condition, new or planned features, products or services, or management strategies. You can identify these forward-looking statements by words such as “may,” “will,” “would,” “should,” “could,” “expect,” “anticipate,” “believe,” “estimate,” “intend,” “plan” and other similar exp However, not all forward-looking statements contain these words. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those discussed under the caption “Risk Factors” in our most recently filed Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission, or the SEC, on February 22, 2018, in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, which was filed with the SEC on August 1, 2018, and in our consolidated financial statements, related notes, and the other information appearing elsewhere in such reports, this report on Form 10-Q and our other filings with the SEC. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. We do not intend, and, except as required by law, we undertake no obligation, to update any of our forward-looking statements after the date of this report to reflect actual results or future events or circumstances.

Unless the context otherwise indicates, references in this Quarterly Report on Form 10-Q to the terms “Shutterstock,” “the Company,” “we,” “our” and “us” refer to Shutterstock, Inc. and its subsidiaries. “Shutterstock,” “Offset,” “Bigstock,” “Re Features” and “PremiumBeat” and their logos are registered trademarks and are the property of Shutterstock, Inc. or one of our subsidiaries. All other trademarks, service marks and trade names appearing in this Quarterly Report on Form 10-Q are the property of their respective owners.

Table of Contents

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

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 206,409	$ 253,428
Accounts receivable, net	45,850	49,932
Prepaid expenses and other current assets	28,331	37,109
Total current assets	280,590	340,469
Property and equipment, net	81,183	85,698
Intangible assets, net	30,611	34,197
Goodwill	88,802	98,654
Deferred tax assets, net	13,966	9,761
Other assets	18,068	8,997
Total assets	$ 513,220	$ 577,776
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,022	$ 7,160
Accrued expenses	55,202	58,734
Contributor royalties payable	23,334	20,088
Deferred revenue	141,412	157,803
Other liabilities	2,679	1,957
Total current liabilities	226,649	245,742
Deferred tax liability, net	—	1,486
Other non-current liabilities	17,973	15,963
Total liabilities	244,622	263,191
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, $0.01 par value; 200,000 shares authorized; 37,573 and 37,270 shares issued and 35,015 and 34,712 shares outstanding as of September 30, 2018 and December 31, 2017, respectively	376	373
Treasury stock, at cost; 2,558 shares as of September 30, 2018 and December 31, 2017	(100,027)	(100,027)
Additional paid-in capital	287,017	272,657
Accumulated comprehensive loss	(4,939)	(3,557)
Retained earnings	86,171	145,139
Total stockholders' equity	268,598	314,585
Total liabilities and stockholders' equity	$ 513,220	$ 577,776

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

Shutterstock, Inc.
Consolidated Statements of Operations
(In thousands, except for per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	$151,575	$141,063	$461,178	$405,282
Operating expenses:				
Cost of revenue	66,461	58,812	198,842	168,512
Sales and marketing	41,028	36,008	123,414	105,620
Product development	14,032	13,340	47,208	37,276
General and administrative	23,355	27,333	74,901	74,716
Total operating expenses	144,876	135,493	444,365	386,124
Income from operations	6,699	5,570	16,813	19,158
Gain on Sale of Webdam	—	—	38,613	—
Other income/(expense), net	217	130	(6,000)	2,095
Income before taxes	6,916	5,700	49,426	21,253
(Benefit)/provision for income taxes	(531)	698	9,652	6,582
Net income	$7,447	$5,002	$39,774	$14,671
Earnings per share:				
Basic	$0.21	$0.14	$1.14	$0.42
Diluted	$0.21	$0.14	$1.12	$0.42
Weighted average shares outstanding:				
Basic	34,991	34,643	34,897	34,607
Diluted	35,570	35,177	35,420	35,339

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$7,447	$5,002	$39,774	$14,671
Foreign currency translation (loss)/gain	1,724	4,325	(1,382)	12,460
Other comprehensive (loss)/income	1,724	4,325	(1,382)	12,460
Comprehensive income	$9,171	$9,327	$38,392	$27,131

See Notes to Unaudited Consolidated Financial Statements.

Table of Contents

Shutterstock, Inc.
Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Nine Months Ended September 30, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$39,774	$14,671
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,934	24,948
Deferred taxes	(6,249)	4,346
Non-cash equity-based compensation	17,994	20,128
Settlement of contingent consideration liability in excess of acquisition-date fair value	—	(6,255)
Gain on Sale of Webdam	(38,613)	—
Loss on impairment of long-term investment	5,881	—
Bad debt expense	911	981
Changes in operating assets and liabilities:		
Accounts receivable	(1,811)	(5,361)
Prepaid expenses and other current and non-current assets	6,941	(10,551)
Accounts payable and other current and non-current liabilities	1,438	11,282
Contributor royalties payable	3,351	(681)
Deferred revenue	4,966	18,002
Net cash provided by operating activities	$68,517	$71,510
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(29,546)	(37,626)
Investment sales, net	—	32,786
Acquisition of business	(845)	(49,512)
Proceeds from Sale of Webdam, net	41,804	—
Other investments/advances	(15,000)	(3,101)
Acquisition of digital content	(2,822)	(2,568)
Security deposit (payment)/release	(43)	30
Net cash used in investing activities	$(6,452)	$(59,991)
CASH FLOWS FROM FINANCING ACTIVITIES		
Purchase of treasury shares	—	(24,977)
Proceeds from exercise of stock options	2,454	1,369
Cash paid related to settlement of employee taxes related to RSU vesting	(6,060)	(5,791)
Cash paid for Special Dividend	(104,925)	—
Settlement of contingent consideration liability	—	(3,745)
Net cash used in financing activities	$(108,531)	$(33,144)
Effect of foreign exchange rate changes on cash	(553)	10,217
Net decrease in cash, cash equivalents and restricted cash	(47,019)	(11,408)
Cash, cash equivalents and restricted cash, beginning of period	256,041	226,803
Cash, cash equivalents and restricted cash, end of period	$209,022	$215,395

Supplemental Disclosure of Cash Information:		
Cash paid for income taxes	$364	$4,137

See Notes to Unaudited Consolidated Financial Statements.

7

Table of Contents
Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

(1) Summary of Operations and Significant Accounting Policies

Summary of Operations

Shutterstock, Inc., together with its subsidiaries (collectively, the “Company” or “Shutterstock”), is a global technology company that offers an e-commerce platform for high-quality digital content, tools and services to creative professionals. The digital content licensed by the Company’s customers includes: (a) imagery, consisting of licensed photographs, vectors, illustrations and video clips that customers use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content; and (b) music, consisting of high-quality music tracks and sound effects, which is often used to complement the digital imagery. The Company licenses creative content to its customers. Contributors upload their creative content to the Company’s websites in exchange for royalty payments based on customer download activity. The Company also offered digital asset management services through its cloud-based digital asset management platform (“Webdam”). As discussed in Note 4, on February 26, 2018, the Company completed a sale transaction, pursuant to which the buyer in the transaction acquired certain assets and assumed certain contracts and liabilities which constituted the Company’s digital asset management business (the “Sale of Webdam”).

Basis of Presentation

The unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all information and footnotes required by GAAP for complete financial statements. The interim consolidated balance sheet as of September 30, 2018, consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2018 and 2017, and consolidated statements of cash flows for the nine months ended September 30, 2018 and 2017 are unaudited. The consolidated balance sheet as of December 31, 2017, included herein, was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP. These unaudited interim financial statements have been prepared on a basis consistent with the Company’s annual financial statements and, in the opinion of management, reflect all adjustments, which include all normal recurring adjustments necessary to state fairly the Company’s financial position as of September 30, 2018, its consolidated results of operations and comprehensive income for the three and nine months ended September 30, 2018 and 2017, and cash flows for the nine months ended September 30, 2018 and 2017. The financial data and the other financial information disclosed in the notes to the financial statements related to these periods are also unaudited. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2018 or for any other future annual or interim period.

These financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2017 included in the Company’s Annual Report on Form 10-K, which was filed with the SEC on February 22, 2018. The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The Company has recorded certain immaterial adjustments to its condensed consolidated financial statements for the correction of errors related to prior periods:

- During the third quarter of 2018, to decrease enterprise revenue by approximately $0.8 million;
- During the second quarter of 2018, to: (i) increase enterprise revenue by approximately $0.4 million and (ii) increase general and administrative expense by approximately $0.8 million;

- During the third quarter of 2017, to increase enterprise revenue by approximately $0.9 million; and
- During the second quarter of 2017, to: (i) reduce enterprise revenue by approximately $0.6 million and (ii) increase general and administrative expense by approximately $0.1 million.

The Company has concluded that the impact of the adjustments recorded in the second and third quarters of 2018 and 2017 is not material to the results of operations or financial position for the periods in which these adjustments were recorded nor any prior quarterly or annual period financial statements.

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

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Such estimates include, but are not limited to, the determination of the allowance for doubtful accounts, the assessment of recoverability of property and equipment, the fair value of acquired goodwill and intangible assets, the grant-date fair value of non-cash equity-based compensation, the assessment of recoverability of deferred tax assets and the measurement of certain contingent non-income tax liabilities.

Revenue Recognition

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

Prior to the adoption of Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”) on January 1, 2018, and reflected in the reported revenue amounts for the three and nine months ended September 30, 2017, the Company recognized revenue when all of the following basic criteria were met: there was persuasive evidence of an arrangement, performance or delivery of services had occurred, the sales price was fixed or determinable, and collectability was reasonably assured. The Company considered persuasive evidence of an arrangement to be an electronic order form, or a signed contract, which contained the fixed pricing terms. Performance or delivery for digital content licenses was considered to have occurred upon the download of the licensed content. Subscription revenue was recognized upon each download using an effective per-license rate and revenue associated with any unused licenses was recognized at the subscription expiration.

Effective January 1, 2018, subsequent to the adoption of ASU 2014-09, the Company recognizes revenue upon the satisfaction of performance obligations, which occurs when (i) digital content is downloaded by a customer or (ii) hosted software services are provisioned and available to a customer. For digital content licenses, the Company recognizes revenue on both its subscription-based and transaction-based sales when content is downloaded, at which time the license is provided. In addition, management estimates expected unused licenses for its subscription-based products and recognizes the revenue associated with the unused licenses throughout the subscription period. The estimate of unused licenses is based on historical download activity and future changes in the estimate could impact the timing of revenue recognition of the Company’s subscription products. Revenue associated with hosted software services is recognized ratably over the term of the license. ASU 2014-09 has resulted in a change in the timing of recognizing revenue on the Company’s digital content license subscription products. ASU 2014-09 did not impact revenue recognition on digital content licenses sold on a transactional basis or license revenue associated with hosted software services.

Prior to the adoption of ASU 2014-09, the Company deferred certain acquisition costs that were then amortized over a period of less than one year. Effective January 1, 2018 the Company expenses contract acquisition costs as incurred, to the extent that the amortization period would otherwise be one year or less.

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

Cash, Cash Equivalents and Restricted Cash

The following represents the Company’s cash, cash equivalents and restricted cash as of September 30, 2018 and December 31, 2017 (in thousands):

	As of September 30, 2018	As of December 31, 2017
Cash and cash equivalents	$ 206,409	$ 253,428
Restricted Cash	2,613	2,613
Total cash, cash equivalents and restricted cash	$ 209,022	$ 256,041

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

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

Allowance for Doubtful Accounts

The Company's accounts receivable consists of customer obligations due under normal trade terms, carried at their face value less an allowance for doubtful accounts, if required. The Company determines its allowance for doubtful accounts based on an evaluation of the aging of its accounts receivable and on a customer-by-customer basis where appropriate. The Company's reserve analysis contemplates the Company's historical loss rate on receivables, specific customer situations and the economic environments in which the Company operates. During the nine months ended September 30, 2018, bad debt expense, which increased the allowance for doubtful accounts, was $0.9 million, and write-offs and other adjustments, which decreased the allowance for doubtful accounts, were $0.5 million. As of September 30, 2018 and December 31, 2017, the Company's allowance for doubtful accounts was approximately $4.5 million and $4.1 million, respectively, which was included as a reduction of accounts receivable.

Deferred Rent

The Company records rent expense on a straight-line basis over the term of the related lease. The difference between the rent expense recognized and the actual payments made in accordance with the lease agreement is recognized as a deferred rent liability on the Company's balance sheet. As of September 30, 2018 and December 31, 2017, the Company had deferred rent of $11.3 million and $11.1 million, respectively, of which $11.0 million and $11.0 million, respectively, was included in other non-current liabilities, and $0.3 million and $0.1 million, respectively, was included in accrued expenses.

Chargeback and Sales Refund Allowance

The majority of the Company's customers purchase products by making an electronic payment with a credit card at the time of a transaction. The Company establishes a chargeback allowance and sales refund reserve allowance based on factors surrounding historical credit card chargeback trends, historical sales refund trends and other information. As of September 30, 2018 and December 31, 2017, the Company's combined allowance for chargebacks and sales refunds was $0.3 million and $0.4 million, respectively, which was included in other liabilities.

Recently Adopted Accounting Standard Updates

In March 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-05, Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 ("ASU 2018-05"). ASU 2018-05 codifies existing SEC guidance contained in SEC Staff Accounting Bulletin No. 118 ("SAB 118"), which expresses the view of the staff regarding application of existing guidance for the accounting for income taxes as it relates to the enactment of the Tax Cuts and Jobs Act (the "TCJA"), which was signed into law in the fourth quarter of 2017. In accordance with ASU 2018-05, the Company has recorded provisional estimates for the accounting impacts of the TCJA, including the transition tax, remeasurement of deferred tax, and other items, due to the uncertainty regarding how these provisions are to be implemented and additional anticipated forthcoming guidance. As management completes the analysis of the impacts of the TCJA, the Company may refine its current estimate and make adjustments, which will be recognized through income in the period such adjustments are identified, as required by ASU 2018-05.

In January 2017, the FASB issued ASU 2017-01, Business Combinations - Clarifying the Definition of a Business. ASU 2017-01 provides additional guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Effective January 1, 2018, the Company adopted

ASU 2017-01 on a prospective basis. Adoption of ASU 2017-01 had no effect on the Company's consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statements of Cash Flows (Topic 230): Restricted Cash ("ASU 2016-18"), which requires entities to present restricted cash with cash and cash equivalents on the statement of cash flows when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The Company adopted ASU 2016-18 retrospectively on January 1, 2018. As a result of this adoption, the Company has revised the presentation of its statement of cash flows for the nine months ended September 30, 2017 to reflect restricted cash of $2.6 million in both the beginning and ending balances of cash, cash equivalents and restricted cash. There were no changes to previously reported amounts of cash used or provided by operating activities, investing activities or financing activities during the period.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), which requires entities to measure all investments in equity securities at fair value and recognize any changes in fair value within the statement of operations. Under the standard, equity investments that do not have readily determinable fair values are eligible for a measurement alternative that allows for these investments to be recorded at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The Company adopted ASU 2016-01 on January 1, 2018. Adoption of ASU 2016-01 had no effect on the Company's consolidated financial statements. ASU 2016-01 may increase the volatility in the statement of operations upon the occurrence of observable price changes or impairments in the equity securities.

In May 2014, the FASB issued ASU 2014-09. ASU 2014-09, together with its related amendments, provides a unified model to determine when and how revenue is recognized and requires certain additional disclosures around the nature, amount, timing, and uncertainty of revenue and cash flows arising from customers. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires deferral of incremental costs associated with the cost of acquiring a customer contract, such as sales commissions, and amortization of such amounts over the contract term. However, as a practical expedient, if the amortization period of the deferred cost would be one year or less, the entity is permitted to expense these costs as incurred.

The Company adopted ASU 2014-09 on January 1, 2018 using the modified retrospective approach, and prior period amounts were not restated. This standard resulted in a change in the timing of recognizing revenue on the Company's digital content license subscription products. The Company has elected to utilize the practical expedient with regard to recognition of expense related to deferred contract acquisition costs, which resulted in a change in the timing of the recognition of such expenses.

The effect of adoption of this new guidance on the consolidated balance sheet as of January 1, 2018 was to reduce prepaid expenses and other current assets and to reduce deferred revenues, with an offsetting increase in 2018 opening retained earnings, as follows (in thousands):

	As Reported December 31, 2017	Adjustment	Revised January 1, 2018
Prepaid expenses and other current assets[1]	37,109	(3,733)	33,376
Deferred revenue	157,803	(9,911)	147,892
Retained earnings	145,139	6,178	151,317

(1) Prepaid expenses and other current assets adjustment is attributable to the reduction in deferred commissions and income tax receivables.

The effect of adoption of this new guidance on the Company's reported balance sheet and statements of operations is as follows (in thousands):

	As Reported Under ASU 2014-09	Impact of Adoption	Under Legacy Guidance
For the three months ended September 30, 2018:			

Revenue	151,575	(404)	151,171
Cost of revenue	66,461	(51)	66,410
Benefit for income taxes	(531)	(56)	(587)
Net loss	7,447	(297)	7,150
For the nine months ended September 30, 2018:			
Revenue	461,178	(1,804)	459,374
Cost of revenue	198,842	(153)	198,689
Provision for income taxes	9,652	(264)	9,388
Net income	39,774	(1,387)	38,387
As of September 30, 2018:			
Prepaid expenses and other current assets	28,331	4,150	32,481
Deferred revenue	141,412	11,715	153,127
Retained Earnings	86,171	(7,565)	78,606

Table of Contents

Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

Recently Issued Accounting Standard Updates

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

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”), as amended. ASU 2016-02 requires that the rights and obligations created by leases with a duration greater than 12 months be recorded as assets and liabilities on the balance sheet of the lessee. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and can be applied using a modified retrospective approach for all leases entered into before the effective date. Early adoption is permitted. The Company’s significant long-term leases relate primarily to its office facilities, which are described in Note 7. Upon adoption of this standard, the Company will record a right of use asset related to its lease agreements. The Company is evaluating the impact of adopting this new accounting standard on its financial statements.

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

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

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

Fair Value Measurements

Money Market Accounts

Cash equivalents include money market accounts which are classified as a level 1 measurement based on quoted prices in active markets for identical assets that the Company can access at the measurement date. During the second quarter of 2018, the Company liquidated its position in money market accounts, and converted the balance to cash. As a result, there are no money market accounts included in cash and cash equivalents as of September 30, 2018. The total amount of money market accounts included in cash and cash equivalents was $55.8 million as of December 31, 2017.

Other Fair Value Measurements

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

Other Long-term Investments

Long-term Lending Facility and Note Receivable

On October 20, 2016, the Company entered into a multi-part transaction with SilverHub Media Limited (“SHM”), an unrelated third-party contributor. The transaction included three primary components: (a) a revolving credit facility pursuant to which the Company would be obligated to lend up to \$4.6 million under certain conditions, (the “Facility”) to SHM. The

Facility had a term of five years and required SHM to make quarterly payments of principal to the Company beginning on the fourth anniversary of the Facility. The Facility bore interest at 10.0%, with all interest payments deferred until maturity, and the entire unpaid balance of principal and accrued interest due upon maturity. In March 2017, the Facility was amended to reduce the maximum lending amount to approximately $3.3 million. As of November 2017, SHM had fully drawn down under the facility and the Company had no additional lending obligation; (b) a distribution agreement, under which the Company is the exclusive distributor of SHM's content in certain markets subject to certain limitations; and (c) an option to acquire SHM at any time after the third anniversary of the Facility or to match any third-party acquisition offer with respect to SHM at any time until the fifth anniversary of the Facility.

Simultaneously with the reduction of the maximum lending amount of the Facility, the Company invested $1.6 million in a convertible note issued by SHM, which had a maturity date of October 20, 2021. The convertible note bore interest at 10.0%, with all interest payments deferred until maturity, and the entire unpaid balance of principal and accrued interest due upon maturity. The principal amount of the convertible note and any accrued and unpaid interest was convertible into equity of SHM at the Company's option on the maturity date, or earlier upon certain events.

In June 2018, SHM breached certain provisions of the distribution agreement, which constituted an event of default under the Facility. As a result of the occurrence of one or more events of default, the Company provided notice to SHM to demand immediate payment of all outstanding borrowings under the Facility and the convertible note, including accrued interest. SHM was unable to pay the outstanding borrowings and accrued interest and therefore, an administrator was appointed and SHM entered into United Kingdom administration (bankruptcy) proceedings. The Company has determined that its investments in SHM, including the Facility, the convertible note, accrued interest and a minor equity investment, experienced an other-than-temporary impairment and therefore, the Company recorded a $5.9 million impairment charge during the three months ended June 30, 2018 in order to reduce the fair value of the Company's investment in SHM to zero. This charge was recorded in Other (expense)/income, net in the consolidated statements of operations. The investment was previously reported within Other assets on the consolidated balance sheet.

Investment in ZCool Technologies Limited ("ZCool")

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

ZCool is a variable interest entity that is not consolidated because the Company is not the primary beneficiary. The Preferred Shares are not deemed to be in-substance common stock and will be accounted for using the measurement alternative for equity investments with no readily determinable fair value. The Preferred Shares will be reported at cost, adjusted for impairments or any observable price changes in ordinary transactions with identical or similar investments issued by ZCool. As of September 30, 2018, the Company's total investment in ZCool is approximately $15.0 million, which is reported within Other assets on the consolidated balance sheet.

(3) Property and Equipment

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

	As of September 30, 2018	As of December 31, 2017

Computer equipment and software	$ 142,347	$ 118,493
Furniture and fixtures	10,032	9,970
Leasehold improvements	19,305	18,487
Property and equipment	171,684	146,950
Less accumulated depreciation	(90,501)	(61,252)
Property and equipment, net	$ 81,183	$ 85,698

Depreciation expense related to property and equipment was $10.3 million and $7.9 million for the three months ended September 30, 2018 and 2017, respectively, and $29.7 million and $19.9 million for the nine months ended September 30, 2018 and 2017, respectively. Depreciation expense is included in Cost of revenue and General and administrative expense in the consolidated statement of operations based on the nature of the asset being depreciated.

13

Capitalized Internal-Use Software

The Company capitalized costs related to the development of internal-use software of $6.4 million and $11.2 million for the three months ended September 30, 2018 and 2017, respectively, and $22.3 million and $25.8 million for the nine months ended September 30, 2018 and 2017, respectively. Capitalized amounts are included as a component of property and equipment under computer equipment and software.

The portion of total depreciation expense related to capitalized internal-use software was $6.6 million and $4.1 million for the three months ended September 30, 2018 and 2017, respectively, and $18.0 million and $9.2 million for the nine months ended September 30, 2018 and 2017, respectively. Depreciation expense related to capitalized internal-use software is included in Cost of revenue and General and administrative expense in the consolidated statement of operations.

As of September 30, 2018 and December 31, 2017, the Company had capitalized internal-use software of $49.6 million and $45.4 million, respectively, net of accumulated depreciation, which was included in property and equipment, net.

(4) Sale of Digital Asset Management Business

On February 26, 2018, the Company completed the Sale of Webdam for an aggregate purchase price of $49.1 million, subject to working capital adjustments. Total cash received, after an initial working capital adjustment, net of transaction costs paid, was $42.3 million with an additional $5.0 million receivable placed in escrow. In the second quarter of 2018, $2.5 million of the funds placed in escrow were released to the Company, and the remaining $2.5 million of funds in escrow are expected to be released to the Company, net of final working capital adjustments, during the first quarter of 2019. The funds in escrow are included as a component of other current assets on the consolidated balance sheet as of September 30, 2018. In addition, approximately $3.0 million of transaction costs related to the sale were paid in the second and third quarters of 2018.

The Company recognized a pre-tax gain on sale of approximately $38.6 million.

(5) Goodwill and Intangible Assets

Goodwill

The Company’s goodwill balance is attributable to its Bigstock, Editorial, Images and Music reporting units and is tested for impairment annually on October 1 or upon a triggering event. Bigstock, Editorial, Images and Music are included in the Company's “Content Business” reportable segment. During the first quarter of 2018, the Company disposed of its Webdam business. The Webdam reporting unit is included in the non-reportable “Other Category” as of December 31, 2017.

The following table summarizes the changes in the Company’s goodwill balance by reportable and non-reportable segments through September 30, 2018 (in thousands):

	Consolidated	Content Business	Other Category
Balance as of December 31, 2017	$ 98,654	$ 89,891	$ 8,763
Foreign currency translation adjustment	(1,089)	(1,089)	—
Sale of Webdam	(8,763)	—	(8,763)
Balance as of September 30, 2018	$ 88,802	$ 88,802	$ —

No triggering events were identified during the nine months ended September 30, 2018.

Table of Contents
Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

Intangible Assets

Intangible assets consisted of the following as of September 30, 2018 and December 31, 2017 (in thousands):

	As of September 30, 2018			As of December 31, 2017	
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Life (Years)	Gross Carrying Amount	Accumulated Amortization
Amortizing intangible assets:					
Customer relationships	$17,702	$ (6,781)	9	$21,008	$ (6,996)
Trade name	6,499	(3,580)	7	7,159	(3,299)
Developed technology	4,824	(3,520)	4	5,528	(3,450)
Contributor content	19,508	(4,301)	10	17,041	(3,066)
Patents	259	(80)	18	259	(68)
Domain name	160	(79)	13	160	(79)
Total	$48,952	$ (18,341)		$51,155	$ (16,958)

During the nine months ended September 30, 2018, the Company completed the Sale of Webdam, which resulted in a reduction of the gross carrying amount and accumulated amortization of intangible assets.

Amortization expense was $1.4 million and $2.3 million for the three months ended September 30, 2018 and 2017, respectively, and $4.2 million and $5.1 million for the nine months ended September 30, 2018 and 2017, respectively. The Company determined that there was no indication of impairment of the intangible assets for any period presented. Estimated amortization expense is: $1.6 million for the remaining three months of 2018, $6.1 million in 2019, $5.5 million in 2020, $4.6 million in 2021, $3.1 million in 2022, $2.8 million in 2023 and $6.9 million thereafter.

(6) Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	As of September 30, 2018	As of December 31, 2017
Compensation	$ 18,208	$ 19,897
Non-income taxes	7,535	6,895
Royalty tax withholdings	8,201	7,566
Other expenses	21,258	24,376
Total accrued expenses	$ 55,202	$ 58,734

(7) Commitments and Contingencies

The Company leases facilities under agreements accounted for as operating leases. Rental expense for operating leases was $2.2 million and $2.3 million for the three months ended September 30, 2018 and 2017, respectively, and $7.0 million and $6.5 million for the nine months ended September 30, 2018 and 2017, respectively. Some leases have defined escalating rent provisions, which are expensed over the term of the related lease on a straight-line basis commencing with the date of possession. Any rent allowance or abatement is netted in this calculation. In addition to contractual rent amounts, the Company's lease payments are also subject to adjustments in real estate taxes and operating expenses.

In 2016, the Company's lease for its office facility in New York City was amended to, among other things, provide for the lease of approximately 25,000 square feet of additional office space and extend the term of the lease. In connection with the underlying lease agreement, the Company entered into a letter of credit as a security deposit for the leased facilities, which was increased to $2.6 million in connection with the 2016 amendment. The letter of credit is collateralized by $2.6 million of cash as of September 30, 2018, which is recorded as restricted cash and is included in Other assets in the consolidated balance sheet. As amended, the lease is scheduled to expire in 2029 and aggregate future minimum payments under the amended lease are approximately $73.9 million.

Other Obligations
As of September 30, 2018, the Company had other obligations in the amount of approximately $70.3 million, which consisted primarily of minimum royalty guarantees and unconditional purchase obligations related to contracts for infrastructure and other business services. As of September 30, 2018, the Company's other obligations for the remainder of 2018 and for the years ending December 31, 2019, 2020, 2021 and 2022 were approximately $8.2 million, $22.3 million, $27.2 million, $9.3 million and $3.3 million, respectively.
Legal Matters
From time to time, the Company may become party to litigation in the ordinary course of business, including direct claims brought by or against the Company with respect to intellectual property, contracts, employment and other matters, as well as claims brought against the Company's customers for whom the Company has a contractual indemnification obligation. The Company assesses the likelihood of any adverse judgments or outcomes with respect to these matters and determines loss contingency assessments on a gross basis after assessing the probability of incurrence of a loss and whether a loss is reasonably estimable. In addition, the Company considers other relevant factors that could impact its ability to reasonably estimate a loss. A determination of the amount of reserves required, if any, for these contingencies is made after analyzing each matter. The Company reviews reserves, if any, at least quarterly and may change the amount of any such reserve in the future due to new developments or changes in strategy in handling these matters. Although the results of litigation and threats of litigation, investigations and claims cannot be predicted with certainty, the Company currently believes that the final outcome of these matters will not have a material adverse effect on its business, consolidated financial position, results of operations, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources and other factors. The Company currently has no material active litigation matters and, accordingly, no material reserves related to litigation.
Indemnification and Employment Agreements
In the ordinary course of business, the Company enters into contractual arrangements under which it agrees to provide indemnification of varying scope and terms to customers with respect to certain matters, including, but not limited to, losses arising out of the breach of the Company's intellectual property warranties for damages to the customer directly attributable to the Company's breach. The Company is not responsible for any damages, costs, or losses to the extent such damages, costs or losses arise as a result of any modifications made by the customer, or the context in which an image is used. The standard maximum aggregate obligation and liability to any one customer for all claims is generally limited to ten thousand dollars. The Company offers certain of its customers greater levels of indemnification, including unlimited indemnification. As of September 30, 2018, the Company had recorded no material liabilities related to indemnification obligations in accordance with the authoritative guidance for loss contingencies. Additionally, the Company believes that it has the appropriate insurance coverage in place to adequately cover such indemnification obligations, if necessary.
Pursuant to the Company's charter documents and separate written indemnification agreements, the Company has certain indemnification obligations to its executive officers, certain employees and directors, as well as certain former officers and directors.
The Company has also entered into employment agreements with its executive officers and certain employees. These agreements specify various employment-related matters, including annual compensation, performance incentive bonuses, and severance benefits in the event of termination with or without cause and in the event of a change in control.
(8) Stockholders' Equity and Equity-Based Compensation
Special Dividend

On August 1, 2018, the Company's Board of Directors declared a special cash dividend of $3.00 per share (the "Special Dividend"), which was paid on August 29, 2018 to stockholders of record at the close of business on August 15, 2018. The aggregate payment made in connection with the Special Dividend was $104.9 million.

In connection with the Special Dividend, and in accordance with the terms of the Company's Amended and Restated 2012 Omnibus Equity Incentive Plan (the "2012 Plan"), the Company adjusted outstanding equity awards in order to prevent dilution of such awards. Accordingly, the Company increased the number of outstanding unvested restricted stock units ("RSUs") and outstanding stock options, and reduced the exercise price of such outstanding stock options, using a conversion ratio of 1.055, which was determined using a ratio of the opening and closing stock price of the Company's common stock on and immediately prior to the ex-dividend date (the "Special Dividend Adjustment").

Table of Contents
Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

Stockholders' Equity
Common Stock
During the nine months ended September 30, 2018, the Company issued approximately 303,000 shares of common stock, primarily related to the exercise of stock options and the vesting of RSUs.
Treasury Stock
In October 2015, the Company's Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to $100 million of its common stock. In February 2017, the Company's Board of Directors approved an increase to the stock repurchase program, pursuant to which the Company is authorized to repurchase up to an additional $100 million of its outstanding common stock. The Company expects to fund future repurchases, if any, through a combination of cash on hand, cash generated by operations and future financing transactions, if appropriate. Accordingly, the Company's stock repurchase program is subject to the Company having available cash to fund repurchases. Under the program, the Company is authorized to purchase shares from time to time through open market purchases or privately negotiated transactions at prevailing prices as permitted by securities laws and other legal requirements, and subject to market conditions and other factors.
During the nine months ended September 30, 2018, the Company did not repurchase any shares of its common stock under the stock repurchase program. As of September 30, 2018, the Company had $100 million of remaining authorization for purchases under the stock repurchase program.
Equity-Based Compensation
The Company recognizes stock-based compensation expense for all share-based payment awards, including employee stock options and RSUs granted under the 2012 Plan, based on the fair value of each award on the grant date.
The following table summarizes non-cash equity-based compensation expense, net of forfeitures, by financial statement line item included in the accompanying consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cost of revenue	$116	$176	$430	$609
Sales and marketing	404	1,092	1,546	3,536
Product development	1,295	1,819	4,510	5,079
General and administrative	4,144	3,798	11,508	10,904
Total	$5,959	$6,885	$17,994	$20,128

The following table summarizes non-cash equity-based compensation expense, net of forfeitures, by award type included in the accompanying consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	$1,521	$1,663	$4,487	$5,087
RSUs	4,438	5,222	13,507	15,041
Total	$5,959	$6,885	$17,994	$20,128

17

Table of Contents
Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

Stock Option Awards

During the nine months ended September 30, 2018, the Company granted approximately 21,000 options to purchase shares of its common stock with a weighted average exercise price of $47.80. In addition, as a result of the Special Dividend Adjustment, the Company increased the number of outstanding awards by approximately 59,000 and reduced the exercise price of all options outstanding as of August 29, 2018. As of September 30, 2018, there were approximately 314,000 options vested and exercisable with a weighted average exercise price of $34.43. As of September 30, 2018, the total unrecognized compensation charge related to non-vested options was approximately $9.4 million, which is expected to be recognized through 2021.

Restricted Stock Units

During the nine months ended September 30, 2018, the Company granted approximately 212,000 RSUs, net of forfeitures. In addition, as a result of the Special Dividend Adjustment, the Company increased the number of outstanding awards by approximately 61,000. As of September 30, 2018 there are approximately 1,133,000 non-vested RSUs outstanding with a weighted average grant-date fair value of $44.04. As of September 30, 2018, the total unrecognized non-cash equity-based compensation charge related to the non-vested RSUs was approximately $33.5 million, which is expected to be recognized through 2022.

During the nine months ended September 30, 2018, shares with an aggregate value of $6.1 million were withheld upon vesting of RSUs and in connection with related remittance of employee withholding taxes to taxing authorities.

(9) Revenue

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

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

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

In addition to the Company’s digital content offerings, the Company has historically generated revenue through other channels:

Digital asset management: The Company provided tools to help organizations manage, search, distribute and collaborate on creative and other brand-buildings activities through Webdam. Effective February 26, 2018, the Company completed the Sale of Webdam. See Note 4 for further information on the Sale of Webdam.

The Company’s revenue by distribution channel for the three and nine months ended September 30, 2018 and 2017 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017[(1)]	2018	2017[(1)]
E-Commerce	$88,713	$81,781	$270,166	$244,555
Enterprise	62,862	55,117	188,301	149,366

Digital asset management [2]	—	4,165	2,711	11,361
Total Revenues	$151,575	$141,063	$461,178	$405,282

(1) As previously discussed in Note 1, the Company adopted ASU 2014-09 effective January 1, 2018 using the modified retrospective approach. Historical revenue amounts reflect those previously reported and have not been restated.

(2) As previously discussed in Note 4, on February 26, 2018, the Company completed the Sale of Webdam. 2018 amounts include revenue earned during the period from January 1, 2018 through February 26, 2018.

The Company's deferred revenue balance decreased from $157.8 million at December 31, 2017 to $141.4 million at September 30, 2018. This decrease was primarily the result of (i) the adoption of ASC 2014-09 which reduced deferred revenue by $9.9 million on January 1, 2018, and (ii) $10.2 million resulting from the Sale of Webdam, partially offset by an increase in deferred revenue due to the ongoing operations of the Company. The September 30, 2018 deferred revenue balance will be earned as digital content is downloaded or upon the expiration of subscription-based products, and nearly all is expected to be earned within the next twelve months. $114.8 million of total revenue recognized for the nine months ended September 30, 2018 was reflected in deferred revenue as of January 1, 2018.

(10) Employee Benefit Plans
The Company has a 401(k) defined contribution plan and, prior to January 1, 2018, provided for annual discretionary employer matching contributions not to exceed 3% of employees' annual base salary per year. Effective January 1, 2018 the Company provides discretionary employer matching of 50% of employees' eligible contributions. Matching contributions are fully vested and non-forfeitable at all times.
The Company recorded expenses related to employer matching contributions of $0.7 million and $0.7 million for the three months ended September 30, 2018 and 2017, respectively, and $2.5 million and $1.5 million for the nine months ended September 30, 2018 and 2017, respectively.

(11) Other Expense/Income, Net
The following table presents a summary of the Company's other income and expense activity included in the accompanying consolidated statements of operations for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Foreign currency (loss)/gain	$(659)	$(192)	$(2,122)	$1,468
Impairment of long-term investments	—	—	(5,881)	—
Interest income	876	322	2,003	627
Total income/(expense)	$217	$130	$(6,000)	$2,095

(12) Income Taxes

On December 22, 2017, the U.S. enacted the TCJA, which lowered the Company's U.S. statutory federal income tax rate from 35% to 21% effective January 1, 2018, while also imposing a one-time transition tax on undistributed earnings of foreign subsidiaries.

The Company's provision for income taxes for the three months ended September 30, 2018 includes provisional amounts for certain specific tax effects of the TCJA. These provisional amounts represent the Company's reasonable estimates. The Company will reevaluate these estimates throughout 2018 as additional information and/or implementation guidance becomes available, and any changes will be reflected in the financial statements in the period in which they are identified.

The Company's effective tax rates yielded a net benefit of 7.7% and a net expense of 12.2% for the three months ended September 30, 2018 and 2017, respectively, and a net expense of 19.5% and 31.0% for the nine months ended September 30, 2018 and 2017, respectively. In the three months ended September 30, 2018, the Company incurred a discrete tax benefit related primarily to the release of reserves for uncertain tax positions due to a lapse in the statute of limitations and the effect of the U.S. Research and Development tax credit claimed on the Company's 2017 tax return, which was substantially completed in the third quarter of 2018. In the nine months ended September 30, 2018, the Company incurred a net discrete tax expense relating primarily to the gain on the Sale of Webdam. The net effect of these discrete items decreased the effective tax rate for the three months ended September 30, 2018 by 22.0% and increased the effective tax rate for the nine months ended September 30, 2018 by 5.2%. In the three and nine months ended September 30, 2017, the Company incurred a discrete tax benefit related primarily to withholding tax incurred on income earned in foreign jurisdictions, the net effect of which increased the effective tax rate by 17.5% and 2.0%, respectively.

The Company has computed the provision for income taxes based on the estimated annual effective tax rate and the application of discrete items, if any, in the applicable period. The estimated annual effective tax rate differs from the statutory tax rate due primarily to the international provisions enacted as part of the TCJA.

During the three and nine months ended September 30, 2018, the Company recorded a tax benefit of $0.9 million related to uncertain tax positions, partially offset by recorded uncertain tax positions that were not material. During the three and nine months ended September 30, 2017, uncertain tax positions recorded by the Company were not material. To the extent the remaining uncertain tax positions are ultimately recognized, the Company's effective tax rate may be impacted in future periods.

The Company recognizes interest expense and tax penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of operations. The Company's accrual for interest and penalties related to unrecognized tax benefits was not material for the three and nine months ended September 30, 2018 and 2017.

During the nine months ended September 30, 2018 and September 30, 2017, the Company paid net cash taxes of $0.4 million and $4.1 million, respectively

(13) Earnings Per Share

Basic earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding during the period. Any potential issuance of common shares, including those that are contingent and do not participate in dividends, is excluded from weighted average number of common shares outstanding.

Diluted earnings per share is computed by dividing the net income or loss attributable to common stockholders by the weighted average common shares outstanding and all potential common shares, if they are dilutive.

Table of Contents
Shutterstock, Inc.
Notes to Consolidated Financial Statements
(unaudited)

A reconciliation of assumed exercised shares used in calculating basic and diluted earnings per share follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Weighted average shares outstanding:				
Basic	34,991	34,643	34,897	34,607
Stock options	148	408	125	458
Unvested RSUs	431	126	398	274
Diluted	35,570	35,177	35,420	35,339
Dilutive securities included in the calculation	1,477	1,066	1,403	1,543
Anti-dilutive securities excluded from the calculation	774	1,554	924	1,244

(14) Geographic Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017[(1)]	2018	2017[(1)]
North America	$57,078	$55,827	$170,092	$161,396
Europe	49,033	45,075	154,258	131,712
Rest of the world	45,464	40,161	136,828	112,174
Total revenue	$151,575	$141,063	$461,178	$405,282

(1) As previously discussed in Note 1, the Company adopted ASU 2014-09 effective January 1, 2018 using the modified retrospective approach. Historical revenue amounts reflect those previously reported and have not been restated.

The United States, included in North America in the above table, accounted for 34% and 36% of consolidated revenue for the three months ended September 30, 2018 and 2017, respectively and 34% and 36% of consolidated revenue for the nine months ended September 30, 2018 and 2017, respectively. No other country accounts for more than 10% of the Company's revenue in any period presented.

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

	September 30, 2018	December 31, 2017
North America	$ 77,076	$ 83,027
Europe	4,046	2,599
Rest of the world	61	72
Total long-lived tangible assets	$ 81,183	$ 85,698

The United States, included in North America in the above table, accounted for 88% and 92% of total long-lived tangible assets as of September 30, 2018 and December 31, 2017, respectively. No other country accounts for more than 10% of the Company's long-lived tangible assets in any period presented.

Table of Contents

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

The following discussion of our financial condition and results of operations should be read together with our interim consolidated unaudited financial statements and related notes contained elsewhere in this Quarterly Report on Form 10-Q and with information contained in our other filings, including the audited consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on February 22, 2018.

In addition to historical consolidated financial information, this discussion contains forward-looking statements including statements about our plans, estimates and beliefs. These statements involve risks and uncertainties and our actual results could differ materially from those expressed or implied in forward-looking statements. See "Forward Looking Statements" above. See also the "Risk Factors" disclosure of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 for additional discussion of the risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements.

Overview and Recent Developments

Shutterstock is a global technology company that offers an e-commerce platform for high-quality digital content, tools and services to creative professionals. The digital content licensed by our customers includes: (a) imagery, consisting of licensed photographs, vectors, illustrations and video clips that customers use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content; and (b) music, consisting of high-quality music tracks and sound effects, which is often used to complement digital imagery. We also offered digital asset management services through Webdam, our cloud-based digital asset management service; on February 26, 2018, we completed a sale transaction, pursuant to which the buyer in the transaction acquired certain assets and assumed certain contracts and liabilities which constituted Webdam (the "Sale of Webdam").

Our platform brings together users and contributors of creative content by providing a readily-searchable collection of content that our customers may pay to license and incorporate into their work and compensating contributors as their content is licensed to our customers. For customers seeking specialized content that goes beyond our library of stock content, our platform also connects customers with contributors who can produce custom branded content. More than 1.8 million active, paying customers contributed to our revenue for the twelve-month period ended September 30, 2018. As of September 30, 2018, more than 550,000 approved contributors made their creative content available in our collection, which has grown to approximately 221 million images and approximately 12 million video clips. This makes our collection of creative content one of the largest of its kind, and we delivered more than 130 million paid downloads across all of our brands during the nine months ended September 30, 2018. We believe that we delivered the highest volume of commercial image downloads in this period of any single brand in our industry during that period.

Through our platform, we generate revenue by licensing creative content to our customers. During the nine months ended September 30, 2018, 59% of our revenue and the majority of our content licenses came from users of our e-commerce platform. E-commerce customers have the flexibility of choosing content subscription plans that provide a large volume of content for their creative process without concern for the incremental cost of each license. For customers with other content needs, we also offer simple, affordable, smaller subscriptions and those where customers have an option to pay for individual content licenses at the time of delivery. Enterprise customers are generally larger organizations or those with unique content, licensing and workflow needs, and our dedicated enterprise sales, service and research teams are able to provide a number of enhancements to their creative workflows beyond the use-cases available on our e-commerce platform including the creation of custom branded content, an offering that launched in 2017. Our enterprise customers provided approximately 41% of our revenue in 2018.

Each time an image, video clip or music track is delivered to a customer for use, we record a royalty expense for the amount due to the associated contributor. Royalties are calculated using either a fixed dollar amount or a fixed percentage of revenue, and are typically paid to contributors on a monthly basis, subject to withholding taxes and certain payout minimums. Royalties represent the largest component of our operating expenses (and are reported within cost of revenue) and tend to increase proportionally with revenue. In addition to content sourced through direct submission through our web properties, content may also be obtained through exclusive distribution agreements with strategic partners or through the direct acquisition of a content library or archive. In certain cases, we will enter into arrangements with contributors whereby we guarantee a minimum royalty to a contributor or strategic partner, usually paid up-front, in exchange for exclusive rights to distribute content when we believe such exclusivity provides us with a distinct competitive advantage. In recent years, we have made a number of enhancements to our content libraries through the direct acquisition of content and through entering into several such agreements and partnerships. We have also enhanced our collections and content acquisition capabilities through our acquisitions of PremiumBeat, Rex Features, The Picture Desk Limited, and Flashstock Technology.

Table of Contents

Our cost of revenue is substantially similar as a percentage of revenue for our e-commerce and enterprise customers. While contributors earn a fixed amount per download for some of our products, we have set the per-download amount paid to our contributors for our products so that contributors earn more per download from products where we collect higher revenue per download. In other words, we strive to deliver a similar percentage of revenue to contributors regardless of the sales channel.

As a provider of digital asset management technology, we also previously generated revenue by licensing the use of our Webdam platform to customers on a contract basis, typically for terms of twelve months.

We manage customer acquisition costs based on the expected blended customer lifetime value across our purchase options so that we are able to manage our marketing expenses to achieve certain desired growth targets. As a result, we do not believe that shifts in the mix between e-commerce and enterprise sales channels will materially impact our operating margins.

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

Key Operating Metrics

In addition to key financial metrics, we regularly review a number of key operating metrics to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe that these metrics can be useful for understanding the underlying trends in our business. The following table summarizes our key operating metrics, which are unaudited, for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017[(1)]	2018	2017
	(in millions, except revenue per download)			
Paid downloads (during the period)	43.9	41.9	132.8	128.1
Revenue per download (during the period)	$ 3.40			