STAMPS.COM INC
Form 10-Q
August 07, 2015

## UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2015
OR

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

For the transition period from $\qquad$ to $\qquad$
Commission file number: 000-26427
Stamps.com Inc.
(Exact name of registrant as specified in its charter)
Delaware
77-0454966
(State or other jurisdiction of incorporation or organization)
(I.R.S. Employer Identification No.)

1990 E. Grand Ave
El Segundo, CA 90245
(Address of principal executive offices, including zip code)
(310) 482-5800
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

$$
\begin{array}{ll}
\text { Large accelerated filer } & \text { Accelerated filer } \\
\text { Non-accelerated filer } & \text { (Do not check if a smaller reporting company) }
\end{array}
$$

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

As of July 31, 2015, there were $16,489,489$ shares of the Registrant's Common Stock issued and outstanding.

STAMPS.COM INC. AND SUBSIDIARIES
FORM 10-Q QUARTERLY REPORT FOR THE QUARTER ENDED JUNE 30, 2015
TABLE OF CONTENTS
Page
PART I - FINANCIAL INFORMATION ..... 1
ITEM 1. FINANCIAL STATEMENTS ..... 1
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
ITEM 3. QUANTITATIVE AND OUALITATIVE DISCLOSURES ABOUT MARKET RISK ..... 28
ITEM 4. CONTROLS AND PROCEDURES ..... 28
PART II - OTHER INFORMATION ..... 29
ITEM 1. LEGAL PROCEEDINGS ..... 29
ITEM
1 A . RISK FACTORS ..... 29
ITEM 2. UNREGISTERED SALES OF EOUITY SECURITIES AND USE OF PROCEEDS ..... 29
ITEM 3. DEFAULTS UPON SENIOR SECURITIES ..... 30
ITEM 4. MINE SAFETY DISCLOSURES ..... 30
ITEM 5. OTHER INFORMATION ..... 30
ITEM 6. EXHIBITS ..... 30

## Table of Contents

PART I - FINANCIAL INFORMATION

## ITEM 1.FINANCIAL STATEMENTS

STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

| June 30, | December |
| :--- | :--- |
| 2015 | 31, |
| (unaudited) | 2014 |

Assets
Current assets:
Cash and cash equivalents \$77,825 \$40,933
Short-term investments
Accounts receivable, net
Deferred income taxes
Other current assets
6,280 6,482

Total current assets
14,654 12,325

Property and equipment, net
2,143 2,143

Goodwill
6,356 6,071

Intangible assets, net
107,258 67,954
29,745 30,427

Long-term investments
Deferred income taxes.
Other assets
66,893 66,893

Total assets
17,953 19,570
6,465 10,215
58,129 51,673
8,770 7,999
\$295,213 \$254,731
Liabilities and Stockholders' Equity
Current liabilities:
Accounts payable and accrued expenses $\$ 38,097 \quad \$ 22,521$
Deferred revenue
Contingent consideration, current
2,241 2,164
Total current liabilities
40,398 9,225
Contingent consideration, long-term
80,736 33,910
Total liabilities
Total liabilities
80,736 49,700
Commitments and contingencies
Stockholders' equity:
Common stock, \$. 001 par value
Authorized shares: 47,500 in 2015 and 2014
Issued shares: 29,217 in 2015 and 28,763 in 2014
Outstanding shares: 16,451 in 2015 and 15,997 in 20145251
Additional paid-in capital
698,935 678,075
Treasury stock, at cost, 12,766 shares in 2015 and 2014 (172,410) (172,410)
Accumulated deficit
Accumulated other comprehensive income
Total stockholders' equity
$(312,147)(300,746)$

Total liabilities and stockholders' equity
$47 \quad 61$
214,477 205,031
\$295,213 \$254,731
The accompanying notes are an integral part of these consolidated financial statements.

## Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

|  | Three Months Ended June 30, |  | Six Months Ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2015 | 2014 | 2015 | 2014 |
| Revenues: |  |  |  |  |
| Service | \$40,378 | \$26,921 | \$76,027 | \$52,564 |
| Product | 4,270 | 3,955 | 9,013 | 8,568 |
| Insurance | 2,631 | 2,047 | 5,293 | 4,040 |
| PhotoStamps | 1,072 | 1,359 | 2,061 | 2,408 |
| Other | 9 | 2 | 18 | 2 |
| Total revenues | 48,360 | 34,284 | 92,412 | 67,582 |
| Cost of revenues (exclusive of amortization of intangible assets, which is included in general and administrative): |  |  |  |  |
| Service | 6,695 | 4,449 | 12,966 | 8,818 |
| Product | 1,435 | 1,292 | 3,036 | 2,834 |
| Insurance | 927 | 717 | 1,850 | 1,405 |
| PhotoStamps | 881 | 1,158 | 1,711 | 2,004 |
| Total cost of revenues | 9,938 | 7,616 | 19,563 | 15,061 |
| Gross profit | 38,422 | 26,668 | 72,849 | 52,521 |
| Operating expenses: |  |  |  |  |
| Sales and marketing | 12,536 | 10,663 | 26,557 | 22,033 |
| Research and development | 4,680 | 3,036 | 8,962 | 5,952 |
| General and administrative | 12,763 | 5,350 | 20,534 | 9,547 |
| Contingent consideration charges | 13,595 | - | 24,107 | - |
| Litigation settlement | 10,000 | - | 10,000 | - |
| Total operating expenses | 53,574 | 19,049 | 90,160 | 37,532 |
| (Loss) income from operations | $(15,152)$ | 7,619 | $(17,311)$ | 14,989 |
| Interest and other (loss) income, net | (14 ) | 89 | 55 | 225 |
| (Loss) income before income taxes | $(15,166)$ | 7,708 | $(17,256)$ | 15,214 |
| Income tax benefit | $(4,735)$ | $(3,466)$ | $(5,855)$ | $(3,294)$ |
| Net (loss) income | \$(10,431) | \$11,174 | \$(11,401) | \$18,508 |
| Net (loss) income per share |  |  |  |  |
| Basic | \$(0.64 ) | \$0.70 | \$(0.70 ) | \$ 1.15 |
| Diluted | \$(0.64 ) | \$0.68 | \$(0.70 ) | \$1.12 |
| Weighted average shares outstanding |  |  |  |  |
| Basic | 16,402 | 15,993 | 16,280 | 16,107 |
| Diluted | 16,402 ${ }^{(1)}$ | 16,378 | 16,280 ${ }^{(1)}$ | 16,521 |

(1) Common equivalent shares are excluded from the diluted (loss) earnings per share calculation as their effect is
antilutive

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

Table of Contents
STAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

|  | Three Months <br> Ended <br> June 30, <br> 2015 | 2014 | Six Months Ended <br> June 30, <br> 2015 | 2014 |
| :--- | :--- | :--- | :--- | :--- |

The accompanying notes are an integral part of these consolidated financial statements.
3

## Table of Contents <br> STAMPS.COM INC. AND SUBSIDIARIES <br> CONSOLIDATED STATEMENTS OF CASH FLOWS <br> (In thousands) <br> (Unaudited)



The accompanying notes are an integral part of these consolidated financial statements.
4

# Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED) 

1. Summary of Significant Accounting Policies

## Basis of Presentation

We prepared the consolidated financial statements included herein pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States ("U.S.") generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading. We recommend that these financial statements be read in conjunction with the audited financial statements and the notes thereto included in our latest annual report on Form 10-K for the fiscal year ended December 31, 2014, filed with the SEC on March 16, 2015.

In our opinion, these unaudited financial statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly our financial position as of June 30, 2015, our results of operations for the three and six months ended June 30, 2015 and our cash flows for the six months ended June 30, 2015. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

## Principles of Consolidation

The consolidated financial statements include the accounts of Stamps.com Inc., Auctane LLC, Interapptive, Inc. and PhotoStamps Inc. In June 2014, we completed our acquisition of $100 \%$ of the outstanding equity of Auctane LLC, the Texas limited liability company that operates ShipStation ("Auctane LLC" or "ShipStation") in a cash and contingent stock transaction. ShipStation, based in Austin, Texas, offers monthly subscription based e-commerce shipping software primarily under the brands ShipStation and Auctane. In August 2014, we completed our acquisition of $100 \%$ of the outstanding equity of Interapptive, Inc., the Missouri corporation that operates ShipWorks ("Interapptive, Inc." or "ShipWorks") in a cash transaction. ShipWorks, based in St. Louis, Missouri, offers monthly subscription based e-commerce shipping software.

Because $100 \%$ of the voting control of Auctane LLC and Interapptive, Inc. is held by us, we have consolidated ShipStation and ShipWorks from the date we obtained control in the accompanying consolidated financial statements. Similarly, due to our $100 \%$ control, PhotoStamps Inc. is also consolidated in the accompanying consolidated financial statements from the date of its inception. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates
The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates, and such differences may be material to the financial statements. Examples include estimates of loss contingencies, promotional coupon redemptions, the number of PhotoStamps retail boxes that will not be redeemed, deferred income taxes, the estimates and assumptions used to calculate the allocation of the purchase price related to our acquisitions, including related contingent consideration, and estimates regarding the useful lives of our building, patents and other amortizable intangible assets.

Fair Value of Financial Instruments

Carrying amounts of certain of our financial instruments, including cash, cash equivalents, accounts receivable and accounts payable, approximate fair value due to their short maturities. The fair values of investments are determined using quoted market prices for those securities or similar financial instruments.

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

Certain contingent consideration may be payable by us in connection with our acquisition of ShipStation. The fair value of the contingent consideration is determined using valuation techniques that replicate the pay-off structure of the earn-out provision in the ShipStation transaction, and the value of each of these options was determined using the Black-Scholes-Merton option pricing framework. During the second quarter of 2015 we incurred approximately $\$ 13.9$ million of charges relating to our contingent consideration liability of which $\$ 13.6$ million was recorded in contingent consideration charges and $\$ 316,000$ was recorded in marketing and research and development in operating expenses. We have incurred approximately $\$ 24.6$ million of charges relating to our contingent consideration liability during the six months ended June 30, 2015 of which $\$ 24.1$ million was recorded in contingent consideration charges and $\$ 501,000$ was recorded in marketing and research and development in operating expenses. Contingent consideration liability was approximately \$40.4 million as of June 30, 2015.

Property and Equipment
We account for property and equipment at cost less accumulated depreciation and amortization. We compute depreciation using the straight-line method over the estimated useful life of the asset, generally three to five years for furniture, fixtures and equipment and ten to forty years for building and building improvements. We have a policy of capitalizing expenditures that materially increase assets' useful lives and charging ordinary maintenance and repairs to operations as incurred. When property or equipment is disposed of, the cost and related accumulated depreciation and amortization are removed, and any gain or loss is included in operations.

## Goodwill

Goodwill represents the excess of the fair value of consideration given over the fair value of the tangible assets, identifiable intangible assets and liabilities assumed in a business combination. We are required to test goodwill for impairment annually and whenever events or circumstances indicate the fair value of a reporting unit may be below its carrying value. Goodwill will be reviewed for impairment annually on October 1 utilizing a qualitative assessment or a two-step process.

## Trademarks, Patents and Intangible Assets

Acquired trademarks, patents and other intangibles include both amortizable and non-amortizable assets and are included in intangible assets, net in the accompanying consolidated balance sheets. Intangible assets are carried at cost less accumulated amortization. Cost associated with internally developed intangible assets is typically expensed as incurred as research and development costs. Amortization of amortizable intangible assets is calculated on a straight-line basis over the estimated useful lives of the assets, ranging from approximately 4 to 17 years.

Impairment of Long-Lived Assets and Intangible Assets
Long-lived assets including intangible assets with finite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Intangible assets that have indefinite useful lives are not amortized but, instead, tested at least annually for impairment while intangible assets that have finite useful lives continue to be amortized over their respective useful lives. Intangible assets with finite lives are reviewed for impairment when events and circumstances indicate that the intangible asset might be impaired.

Table of Contents<br>STAMPS.COM INC AND SUBSIDIARY<br>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS<br>(UNAUDITED)

## Income Taxes

We account for income taxes in accordance with Financial Accounting Standards Board ("FASB") ASC Topic No. 740, Income Taxes ("ASC 740"), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the net deferred tax assets will not be realized. We record a valuation allowance to reduce our gross deferred tax assets, which are primarily comprised of U.S. Federal and State tax loss carry-forwards, to the amount that is more likely than not (a likelihood of more than 50 percent) to be realized. In order for us to realize our deferred tax assets, we must be able to generate sufficient taxable income. We evaluate the appropriateness of our deferred tax assets and related valuation allowance in accordance with ASC 740 based on all available positive and negative evidence. As of June 30, 2015 and December 31, 2014 we do not have any valuation allowance recorded to reduce our gross deferred tax assets as we believe we have met the more likely than not threshold we will realize our tax loss carry-forwards in the foreseeable future.

## Deferred Revenue

Our deferred revenue relates to service revenue and PhotoStamps retail boxes. Deferred revenue related to our service revenue generally arises due to the timing of payment versus the provision of services for certain customers billed in advance. We sell our PhotoStamps retail boxes to our customers through our website and selected third parties. Proceeds from the sale of our PhotoStamps retail boxes are initially recorded as a liability when received. We record the liability for outstanding PhotoStamps retail boxes in deferred revenue.

## Revenue Recognition

We recognize revenue from product sales or services rendered, as well as commissions from advertising or sale of products by third party vendors to our customer base when the following four revenue recognition criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectability is reasonably assured.

Service revenue is primarily derived from monthly subscription and transaction fees and is recognized in the period that services are provided. Product sales, net of return allowances, are recorded when the products are shipped and title passes to customers. Sales of items, including PhotoStamps, sold to customers are made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier. Return allowances for expected product returns, which reduce product revenue, are estimated using historical experience. Commissions from the advertising or sale of products by a third party vendor to our customer base are recognized when the revenue is earned and collection is deemed probable.

Customers typically pay face value for postage purchased for use through our mailing and shipping software, and the funds are transferred directly from the customers to the United States Postal Services ("USPS"). We do not recognize revenue for this postage, as it is purchased by our customers directly from the USPS.

PhotoStamps revenue, which includes the face value of postage, from the sale of PhotoStamps sheets and rolls is made pursuant to a sales contract that provides for transfer of both title and risk of loss upon our delivery to the carrier.

Sales of PhotoStamps retail boxes are initially recorded as deferred revenue. PhotoStamps revenue related to the sale of these PhotoStamps retail boxes is subsequently recognized when either: 1) the PhotoStamps retail box is redeemed, or 2) the likelihood of the PhotoStamps retail box being redeemed is deemed remote ("breakage") and there is no legal obligation to remit the value of the unredeemed PhotoStamps retail boxes.

On a limited basis, we allow third parties to offer products and promotions to our customer base. These arrangements generally provide payment in the form of a flat fee or revenue sharing arrangements where we receive payment upon customers accessing third party products and services. During the second quarter of 2015 and 2014 revenue from such advertising arrangements was not significant.

We provide our customers with the opportunity to purchase parcel insurance directly through our solutions. Insurance revenue represents the gross amount charged to the customer for purchasing insurance and the related cost represents the amount paid to our insurance brokers. We recognize revenue on insurance purchases upon the ship date of the insured package.

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

PhotoStamps Retail Boxes

We sell PhotoStamps retail boxes that are redeemable for PhotoStamps on our website. The PhotoStamps retail boxes are sold through various third party retail partners. Our PhotoStamps retail boxes are not subject to administrative fees on unredeemed boxes and have no expiration date. PhotoStamps retail box sales are recorded as deferred revenue. We concluded that sufficient company-specific historical evidence existed to determine the period of time after which the likelihood of the PhotoStamps retail boxes being redeemed was remote. Based on our analysis of the redemption data, we estimate that period of time to be 60 months after the sale of our PhotoStamps retail boxes.

We recognize breakage revenue related to our PhotoStamps retail boxes utilizing the redemption recognition method. Under the redemption recognition method, we recognize breakage revenue from unredeemed retail boxes in proportion to the revenue recognized from the retail boxes that have been redeemed. Revenue from our PhotoStamps retail boxes is included in PhotoStamps revenue. During second quarter of 2015 and 2014 PhotoStamps retail box breakage revenue was not significant.

In May 2014 FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09") an updated standard on revenue recognition. This ASU will supersede the revenue recognition requirements in Accounting Standards Codification Topic 605, Revenue Recognition, and most industry-specific guidance. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using US GAAP and International Financial Reporting Standards. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. In doing so we may be required to use more judgment and make more estimates than under current authoritative guidance. ASU 2014-09 will be effective in the first quarter of fiscal 2018 and may be applied on a full retrospective or modified retrospective approach. We are currently evaluating the impact the adoption of this standard will have on our consolidated financial statements.

## Short- Term Financing Obligation

We utilize short-term financing to fund certain company operations. As of June 30, 2015 we had $\$ 1.9$ million in short-term financing obligations, which was included in accounts payable and accrued expenses and $\$ 10.1$ million of unused credit.

## Subsequent Events

We are not aware of any material subsequent events or transactions that have occurred that would require recognition in the financial statements or disclosure in the notes to the consolidated financial statements except as described in Note 3 - "Commitments and Contingencies."

## 2. Acquisition

## Endicia Acquisition

On March 22, 2015 we entered into a Stock Purchase Agreement ("Stock Purchase Agreement") with PSI Systems, Inc., a California corporation d/b/a Endicia ("Endicia"), and Newell Rubbermaid Inc., a Delaware corporation ("Newell"). Endicia, based in Palo Alto, California, is a leading provider of high volume shipping technologies and solutions for
shipping with the USPS. The Stock Purchase Agreement provides for our purchase of all of the issued and outstanding shares of common stock of Endicia from a wholly-owned indirect subsidiary of Newell ("Transaction") for an aggregate purchase price of $\$ 215$ million in cash. The purchase price is subject to adjustment for changes in Endicia's net working capital as of the date of the closing of the Transaction and certain transaction expenses and closing cash adjustments. The closing of the Transaction is subject to various customary conditions, including regulatory approval. The Transaction is not subject to a shareholder approval requirement.

## 8

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

Stamps.com and Newell have certain rights to terminate the Stock Purchase Agreement including if the closing of the Transaction has not occurred on or prior to the date that is six months from the date of the Stock Purchase Agreement ("Termination Date"), provided, however, that the Termination Date will be automatically extended up to a date that is eighteen months after the date of the Stock Purchase Agreement in circumstances principally related to antitrust approval having not yet been obtained; provided, further, that under certain circumstances Newell can reduce the Termination Date to be a date that is twelve (12) months after the date of the Stock Purchase Agreement if we have not provided certain assurances as to extensions of our credit arrangements for the Transaction or other alternatives to such extensions.

In the event that the Stock Purchase Agreement is terminated under certain circumstances related to the failure to obtain antitrust regulatory approval, the Stock Purchase Agreement provides for us to pay to Newell $\$ 10,750,000$.

Concurrent with the signing of the Stock Purchase Agreement, we entered into a financing commitment letter ("Commitment Letter") with Wells Fargo Bank, National Association ("Wells Fargo Bank"), Wells Fargo Securities, LLC, Bank of America, N.A. ("Bank of America"), Merrill Lynch, Pierce, Fenner \& Smith Incorporated, J.P. Morgan Chase Bank, N.A. ("JPMorgan" and, collectively with Wells Fargo Bank and Bank of America, the "Lead Lenders"), and J.P. Morgan Securities LLC. The Commitment Letter provides, on the terms and subject to the conditions set forth in the Commitment Letter, for a secured term loan facility in an aggregate principal amount of $\$ 82.5$ million ("Term Loan") and a secured revolving credit facility in an aggregate principal amount of $\$ 82.5$ million (the "Revolving Credit Facility," and together with the Term Loan, the "Credit Facilities"). The proceeds of the Term Loan will be used to finance a portion of the Purchase Price and for the payment of fees and expenses incurred in connection with the entering into the Stock Purchase Agreement and the Credit Facilities. The Revolving Credit Facility will be used to finance a portion of the Purchase Price and for our ongoing working capital and other general corporate purposes. We expect the financing under the Commitment Letter, together with cash balances, to be sufficient to provide the financing necessary to pay the Purchase Price. The financing commitments of the Lead Lenders are subject to certain limited conditions set forth in the Commitment Letter.

During the second quarter, Stamps.com and Newell have each received a Request for Additional Information, or a "second request," from the United States Department of Justice (DOJ) in connection with the DOJ's review of Stamps.com's proposed acquisition of PSI Systems, Inc. (d/b/a Endicia) from Newell under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the Act). This second request from the DOJ is a standard part of the full regulatory process. The transaction, which was announced March 24, 2015, is subject to satisfaction of customary closing conditions, including expiration or termination of the waiting period under the Act. The effect of the second request is to extend the waiting period imposed by the Act until 30 days after Stamps.com and Newell have substantially complied with the second request, unless that period is extended voluntarily by the parties or terminated sooner by the DOJ. Stamps.com and Newell are gathering information to respond promptly to the second request and are cooperating with the DOJ in connection with its review

## 3.Commitments and Contingencies

Legal Proceedings
On August 14, 2014, Rapid Enterprises, LLC, D/B/A Express 1, filed suit against ShipStation and some of its executives in the Third Judicial District Court for Salt Lake County, Utah, alleging, among other claims, that ShipStation breached its contract with Express 1 by violating an exclusivity provision. Express 1 seeks an injunction, damages, attorneys' fees and court costs. On December 12, 2014, Express 1 added additional claims and Stamps.com
and our Chief Executive Officer as named defendants.

On August 6, 2015, Stamps.com and Express 1 entered into a settlement agreement that resolves all disputes between the parties. Stamps.com agreed to pay Express $1 \$ 10,000,000$ in exchange for Express 1 's dismissal and permanent withdrawal of Express 1's tort claims. In addition, the parties agreed to continue and expand their business relationship going forward.

9

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

Express 1 is a sales and support business partner for the United States Postal Service that provides discounted shipping rates and technology solutions to lower volume USPS shippers. Though our partnership with Express 1, Stamps.com and our subsidiaries are able to provide Express 1's shipping discounts to our lower volume customers, and Express 1 is able to utilize our systems and software to better serve its customers.

The above settlement related to events that occurred prior to June 30, 2015. Therefore the $\$ 10,000,000$ litigation settlement expense and associated liability were included in our consolidated financial statements as of and for the three and six months ended June 30, 2015.

We are a party to various legal proceedings, including those noted in this section. We have established loss provisions only for matters in which losses are probable and can be reasonably estimated. Although management at present believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not materially harm our financial position, results of operations, cash flows, or overall trends, legal proceedings are subject to inherent uncertainties, and unfavorable rulings or other events could occur. An unfavorable outcome for an amount in excess of management's present beliefs may result in a material adverse impact on our business, results of operations, financial position, and overall trends.

## Commitments

The following table is a schedule of our significant contractual obligations and commercial commitments, which consist only of future minimum lease payments under operating leases as of June 30, 2015 (in thousands):

|  | Operating <br> Lease |
| :--- | :--- |
| Twelve Month Period Ending June 30, |  |
| Obligations |  |
| 2016 | $\$ 373$ |
| 2017 | 263 |
| 2018 | 269 |
| 2019 | 136 |
| Thereafter | - |
| Total | $\$ 1,041$ |

4. Net (Loss) Income per Share

Net (loss) income per share represents net (loss) income attributable to common stockholders divided by the weighted average number of common shares outstanding during a reported period. The diluted net (loss) income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock, including stock options (commonly and hereafter referred to as "common stock equivalents"), were exercised or converted into common stock. Diluted net (loss) income per share is calculated by dividing net (loss) income during a reported period by the sum of the weighted average number of common shares outstanding plus common stock equivalents for the period.

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

The following table reconciles share amounts utilized to calculate basic and diluted net (loss) income per share (in thousands, except per share data):

|  | Three Months Ended June 30, |  | Six Months Ended June 30, |  |
| :---: | :---: | :---: | :---: | :---: |
| Net (loss) income | \$(10,431) | \$11,174 | \$ $(11,401)$ | \$18,508 |
| Basic - weighted average common shares | 16,402 | 15,993 | 16,280 | 16,107 |
| Diluted effect of common stock equivalents | (1) | 385 | ${ }^{(1)}$ | 414 |
| Diluted - weighted average common shares | 16,402 | 16,378 | 16,280 | 16,521 |
| (Loss) earnings per share: |  |  |  |  |
| Basic | \$(0.64 | \$0.70 | \$(0.70 | \$1.15 |
| Diluted | \$(0.64 ) | \$0.68 | \$(0.70 | \$1.12 |

(1) Common equivalent shares are excluded from the diluted (loss) earnings per share calculation as their effect is anti-dilutive.

The calculation of dilutive shares excludes the effect of the following options that are considered anti-dilutive (in thousands):

|  | Three |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
|  | Months | Six Months |  |  |
|  | Ended | Ended |  |  |
|  | June 30, | June 30, |  |  |
|  | 2015 | 2014 | 2015 | 2014 |
| Anti-dilutive stock option shares | 2,992 | 171 | 2,978 | 140 |

## 5. Stock-Based Employee Compensation

We estimate the fair value of share-based payment awards on the date of grant using an option-pricing model and recognize stock-based compensation expense during each period based on the value of that portion of share-based payment awards that is ultimately expected to vest during the period, reduced for estimated forfeitures. We estimate forfeitures at the time of grant based on historical data and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense recognized for all employee stock options granted is recognized using the straight-line method over their respective vesting periods of up to five years.

The following table sets forth the stock-based compensation expense that we recognized for the periods indicated (in thousands):

| Three Months | Six Months |
| :--- | :--- |
| Ended | Ended |
| June 30, | June 30, |
| 2015 | 2014 |
| $2015 \quad 2014$ |  |

Stock-based compensation expense relating to:

Employee and director stock options
Employee stock purchases
Total stock-based compensation expense
$\begin{array}{llll}\$ 3,274 & \$ 926 & \$ 5,802 & \$ 1,826\end{array}$
$127 \quad$ - $\quad 241 \quad 116$
$\begin{array}{llll}\$ 3,401 & \$ 926 & \$ 6,043 & \$ 1,942\end{array}$

Stock-based compensation expense relating to:
Cost of revenues
\$201 \$83 \$368 \$185

Sales and marketing
$853141 \quad 1,575$

334
Research and development
General and administrative
Total stock-based compensation expense
$617 \quad 164 \quad 1,165 \quad 400$
$\begin{array}{llll}1,730 & 538 & 2,935 & 1,023\end{array}$
$\begin{array}{llll}\text { \$3,401 } & \$ 926 & \$ 6,043 & \$ 1,942\end{array}$

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

We use the Black-Scholes option valuation model to estimate the fair value of share-based payment awards on the date of grant, which requires us to make a number of subjective assumptions, including stock price volatility, expected term, and risk-free interest rates. In the case of options we grant, our assumption of expected volatility is based on the historical volatility of our stock price over the term equal to the expected life of the options. We base the risk-free interest rate on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life of the options assumed at the date of grant. The estimated expected life represents the weighted-average period the stock options are expected to remain outstanding, determined based on an analysis of historical exercise behavior.

The following are the weighted average assumptions used in the Black-Scholes valuation model for the periods indicated:

|  | Three |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Months |  | Six Months |  |
|  | Ended |  | Ended |  |
|  | June 30 |  | June 30 |  |
|  | 2015 | 2014 | 2015 | 2014 |
| Expected dividend yield | - | - | - | - |
| Risk-free interest rate | 0.9\% | 0.9 \% | 1.0\% | 0.8 \% |
| Expected volatility | 45 \% | 50 \% | 46 \% | 50 \% |
| Expected life (in years) | 3.4 | 3.4 | 3.4 | 3.5 |
| Expected forfeiture rate | 6 \% | 6 \% | $6 \%$ | 6 \% |

## 6. Goodwill and Intangible Assets

Goodwill represents the excess of the fair value of consideration given over the fair value of the tangible assets, identifiable intangible assets and liabilities assumed in a business combination. Goodwill was approximately $\$ 66.9$ million as of June 30, 2015 and December 31, 2014.

Goodwill is not subject to amortization and is tested annually for impairment, and tested for impairment more frequently if events and circumstances indicate that the assets might be impaired. In connection with our goodwill impairment analysis performed annually in our fourth quarter, we first assess qualitative factors to determine whether events or circumstances indicate that the fair value of our reporting units is less than their carrying value. If, after assessing the totality of events or circumstances, we determine it is more likely than not the fair value of a reporting unit is less than its carrying amount, then we perform the two-step impairment test. The first step of the two-step impairment analysis is to determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units. We determine the fair value of each reporting unit using the discount cash flow approach and a market base approach. To the extent the carrying amount of a reporting unit exceeds its fair value, we would be required to perform the second step of the impairment analysis, as this is an indication that the reporting unit goodwill may be impaired. In this step, we compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all the assets (recognized and unrecognized) and liabilities of the reporting unit. The residual fair value after this allocation is the amount we would be required to recognize as impairment loss. The process of evaluation the potential impairment of goodwill is subjective and requires judgment at many points during the test including future revenue forecast and discount rates.

We have amortizable and non-amortizable intangible assets consisting of patents, trademarks, lease-in-place intangible assets, developed technology, non-compete agreements and customer relationships totaling approximately $\$ 29.5$ million in gross carrying amount as of June 30, 2015 and December 31, 2014.

12

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table summarizes our amortizable intangible assets as of June 30, 2015 (in thousands):

|  | Gross |  | Net |
| :--- | :---: | :--- | :--- |
|  | Carrying | Accumulated | Carrying |
|  | Amount | Amortization | Amount |
| Patents and Others | $\$ 8,889$ | $\$ 8,706$ | $\$ 183$ |
| Customer Relationships | 11,300 | 1,505 | 9,795 |
| Technology | 7,000 | 903 | 6,097 |
| Non-Compete | 1,100 | 251 | 849 |
| Trademark | 700 | 160 | 540 |
| Total amortizable intangible assets at June 30, 2015 | $\$ 28,989$ | $\$ 11,525$ | $\$ 17,464$ |

We recorded amortization of intangible assets totaling approximately $\$ 1.6$ million and $\$ 204,000$ for the six months ended June 30, 2015 and 2014, respectively, which is included in general and administrative expense in our accompanying consolidated statements of operations.

As of June 30, 2015, the remaining weighted average amortization period for our amortizable intangible assets is approximately 6.0 years. Our estimated amortization expense for the next five years and thereafter is as follows (in thousands):

|  | Estimated <br> Amortization |
| :--- | :--- |
| Twelve Month Period Ending June 30, |  |
| Expense |  |
| 2016 | $\$ 2,895$ |
| 2017 | 2,895 |
| 2018 | 2,882 |
| 2019 | 2,524 |
| 2020 | 2,449 |
| Thereafter | 3,819 |

## 7.Income Taxes

During the second quarter of 2015 our income tax benefit was approximately $\$ 4.7$ million, which is primarily attributable to our second quarter pre-tax loss and deferred income taxes. Our actual effective tax rate during the second quarter of 2015 differs from statutory federal rate as a result of several factors, including non-temporary differences and state and local income taxes. During the second quarter of 2014 our income tax benefit was approximately $\$ 3.5$ million which consisted of federal and state alternative minimum taxes of approximately $\$ 167,000$ offset by a valuation release of approximately $\$ 3.6$ million. Our effective income tax rate during the second quarter of 2014 differs from the statutory income tax rate primarily as a result of our use of net operating losses to offset current federal and state income taxes. We evaluated the appropriateness of our deferred tax assets and related valuation allowance in accordance with ASC 740 based on all available positive and negative evidence.

On June 10, 2014 we completed our acquisition of ShipStation. On August 29, 2014 we completed our acquisition of ShipWorks. Based on these discrete events, we re-evaluated our forecast of our projected taxable income. As a result, we released a portion of our valuation allowance totaling approximately $\$ 3.6$ million and $\$ 345,000$ during the second and third quarter of 2014, respectively. After analyzing our deferred tax assets including our remaining tax loss
carry-forward and completing our forecast of future income taking into consideration potential synergy of the acquisitions, we believed we met the more likely than not threshold that we will be able to utilize our remaining tax loss carry-forward in the foreseeable future. As a result we released the remaining valuation allowance of approximately $\$ 9.6$ million during the fourth quarter of 2014. As of June 30, 2015 and December 31, 2014, we do not have any valuation allowance against our net deferred tax assets.

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Table of Contents
STAMPS.COM INC AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
8.Fair Value Measurements

Financial assets measured at fair value on a recurring basis are classified in one of the three following categories, which are described below:

Level 1 - Valuations based on unadjusted quoted prices for identical assets in an active market
Level 2 Valuations based on quoted prices in markets where trading occurs infrequently or whose values are based on - quoted prices of instruments with similar attributes in active markets

Level 3 Valuations based on inputs that are unobservable and involve management judgment and our own - assumptions about market participants and pricing

The following table summarizes our financial assets measured at fair value on a recurring basis (in thousands):

|  |  | Fair Value Measurement at |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  |  | Reporting Date Using |
| Quoted |  |  |


| Available-for-sale debt securities | 16,697 | - | 16,697 |  | - |
| :--- | ---: | :--- | ---: | ---: | ---: |
| Total | $\$ 57,630$ | $\$ 40,933$ | $\$ 16,697$ | $\$$ | - |

The fair value of our available-for-sale debt securities included in the Level 2 category is based on the market values obtained from an independent pricing service that were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers.

As of June 30, 2015 contingent consideration relating to our acquisition of ShipStation was approximately $\$ 40.4$ million. The fair value of the contingent consideration was determined based on a probability weighted method, which incorporates management's forecasts of financial measures and the likelihood of the financial measure targets being achieved using a series of options that replicate the pay-off structure of the earn-out, and the value of each of these options was determined using the Black-Scholes-Merton option pricing framework.

14

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

The following table summarizes our contingent consideration measured at fair value on a recurring basis (in thousands):


The following table represents a reconciliation of contingent consideration obligation measured on a recurring basis using significant unobservable inputs (Level 3) as of June 30, 2015 (in thousands):

June 30,
2015

| Beginning of year balance | $\$ 25,015$ |
| :--- | :---: |
| Contingent consideration distribution | $(9,225)$ |
| Contingent consideration charges ${ }^{(1)}$ | 24,107 |
| Contingent consideration compensation expense ${ }^{(1)}$ | 501 |
| End of quarter balance | $\$ 40,398$ |

This amount represents fair value adjustment during the first and second quarter of 2015 to contingent consideration recorded associated with the acquisition of ShipStation. The $\$ 24.1$ million contingent consideration
(1) charge is recorded as a separate line item in our consolidated statement of operations. The $\$ 501,000$ compensation expense for the adjustment of contingent consideration liability relating to certain employees is recorded in marketing and research and development in operating expenses.

## 9.Cash Equivalents and Investments

Our cash equivalents and investments consist of money market, U.S. government obligations, asset-backed securities and public corporate debt securities at June 30, 2015 and December 31, 2014. We consider all highly liquid investments with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents. All of our investments are classified as available for sale and are recorded at market value using the specific identification method. Realized gains and losses are reflected in other income, net using the specific identification method. There was no material realized gain or loss with respect to our investments during the three and six months ended June 30, 2015. Unrealized gains and losses are included as a separate component of stockholders' equity. We do not intend to sell investments with an amortized cost basis exceeding fair value and it is
not likely that we will be required to sell the investments before recovery of their amortized cost bases. We have 6 securities with a total fair value of $\$ 3.0$ million that have unrealized losses of approximately $\$ 8,000$ as of June 30 , 2015.

On at least a quarterly basis, we evaluate our available for sale securities, and record an "other-than-temporary impairment" ("OTTI") if we believe their fair value is less than historical cost and it is probable that we will not collect all contractual cash flows. We did not record any OTTI during the three and six months ended June 30, 2015, after evaluating a number of factors including, but not limited to:
-How much fair value has declined below amortized cost
-The financial condition of the issuers

- Significant rating agency changes on the issuer

Our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value

15

## Table of Contents <br> STAMPS.COM INC AND SUBSIDIARY <br> NOTES TO CONSOLIDATED FINANCIAL STATEMENTS <br> (UNAUDITED)

The following table summarizes our cash, cash equivalents and investments as of June 30, 2015 and December 31, 2014 (in thousands):

|  | June 30, 2015 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Cost or Gross <br> AmortizedUnrealized |  | Gross <br> Unrealized <br> Losses | Estimated <br> Fair <br> Value |
|  |  |  |  |  |
|  | Cost | Gains |  |  |
| Cash and cash equivalents: |  |  |  |  |
| Cash | \$70,745 | - | - | \$ 70,745 |
| Money market | 7,080 | - | - | 7,080 |
| Cash and cash equivalents | 77,825 | - | - | 77,825 |
| Short-term investments: |  |  |  |  |
| Corporate bonds and asset backed securities | 4,774 | 8 | (3) | ) 4,779 |
| U.S. government and agency securities | 1,499 | 2 | - | 1,501 |
| Short-term investments | 6,273 | 10 | (3) | ) 6,280 |
| Long-term investments: |  |  |  |  |
| Corporate bonds and asset backed securities | 6,425 | 46 | (6) | ) 6,465 |
| Long-term investments | 6,425 | 46 | (6) | ) 6,465 |
| Cash, cash equivalents and investments | \$90,523 | 56 | (9 ) | ) \$ 90,570 |


| Cash and cash equivalents: |  |  |  |  |  |
| :--- | :---: | :--- | :--- | :---: | :---: |
| Cash | $\$ 37,870$ | - | - | $\$ 37,870$ |  |
| Money market | 3,063 | - | - | 3,063 |  |
| Cash and cash equivalents | 40,933 | - | - | 40,933 |  |
| Short-term investments: |  |  |  |  |  |
| Corporate bonds and asset backed securities | 4,960 | 23 | $(1$ | $)$ | 4,982 |
| U.S. government and agency securities | 1,498 | 2 | - |  | 1,500 |
| Short-term investments | 6,458 | 25 | $(1$ | $)$ | 6,482 |
| Long-term investments: |  |  |  |  |  |
| Corporate bonds and asset backed securities | 10,178 | 46 | $(9$ | $)$ | 10,215 |
| Long-term investments | 10,178 | 46 | $(9$ | $)$ | 10,215 |
| Cash, cash equivalents and investments | $\$ 57,569$ | 71 | $(10$ | $) \$ 57,630$ |  |

The following table summarizes contractual maturities of our marketable fixed-income securities as of June 30, 2015 (in thousands):

|  |  | Estimated |
| :--- | :--- | :--- |
|  | Amortized | Fair <br> lost |
| Value |  |  |
| Due within one year | $\$ 6,273$ | $\$ 6,280$ |
| Due after one year through five years | 6,387 | 6,415 |
| Due after five years through ten years | 38 | 50 |

Total \$12,698 \$ 12,745

## Table of Contents

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

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 (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements relate to expectations concerning matters that are not historical facts. You can find many (but not all) of these statements by looking for words such as "approximates," "believes," "expects," "seeks," "anticipates," "estimates," "intends," "plans," "would," "could,""should," "will," "may" or other similar expressions We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. We caution investors that any forward-looking statements presented in this report, or that we may make orally or in writing from time to time, are based on beliefs and assumptions made by, and information currently available to, us. Such statements are based on assumptions, and the actual outcome will be affected by known and unknown risks, trends and uncertainties and factors that are beyond our control or ability to predict. Although we believe that our assumptions are reasonable, they are not guarantees of future performance, and some will inevitably prove to be incorrect. As a result, our actual future results may differ from our expectations, and those differences may be material. We are not undertaking any obligation to update any forward-looking statements. Accordingly, investors should use caution in relying on past forward-looking statements, which are based on known results and trends at the time they are made, to anticipate future results or trends.

Please refer to the risk factors under "Item 1A. Risk Factors" of our Form 10-K for the year ended December 31, 2014 as well as those described elsewhere in our public filings. The risks included are not exhaustive, and additional factors could adversely affect our business and financial performance. We operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. This Report and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.

Stamps.com, NetStamps, PhotoStamps, Hidden Postage, Stamps.com Internet postage and the Stamps.com logo are our trademarks. This report also references trademarks of other entities.

## Overview

Stamps.com® is a leading provider of Internet-based mailing and shipping solutions. Under the Stamps.com branded solutions, our customers use our service to mail and ship a variety of mail pieces, including postcards, envelopes, flats and packages, using a wide range of United States Postal Service ("USPS") mail classes, including First Class Mail®, Priority Mail®, Priority Mail Express $®$, Media Mail ${ }^{\circledR}$, Parcel Select ${ }^{\circledR}$, and others. Customers using our service receive discounted postage rates compared to USPS retail on certain mail pieces such as First Class letters and domestic and international Priority Mail and Priority Mail Express packages. Our customers include individuals, small businesses, home offices, medium-size businesses and large enterprises. We were the first ever USPS-licensed vendor to offer mailing and shipping in a software-only business model in 1999. In addition, we now offer multi-carrier shipping solutions under the brand names ShipStation® and ShipWorks ${ }^{\circledR}$ as a result of our recent acquisitions.

Services and Products
Mailing and Shipping Business

Our mailing and shipping solutions under the Stamps.com brand enable our customers to buy and print USPS approved postage and services with just a personal computer ("PC"), printer and Internet connection, right from their home or office.

17

## Table of Contents

We offer the following mailing and shipping products and services to our customers under the Stamps.com, ShipStation and ShipWorks brands:


#### Abstract

USPS Mailing and Shipping Services. After completing the registration process, customers can purchase and print postage 24 hours a day, seven days a week, through our software or web interface. Typically, when a customer .purchases postage for use through our service, the customer pays the face value of the postage, and the funds are transferred directly from the customer's account to the USPS's account. The customer then draws down their prepaid account balance as they print postage and repurchase postage as necessary. Customers typically pay a monthly subscription fee for access to our service.


Our USPS-approved mailing and shipping service enables users to print "electronic stamps" directly onto envelopes, plain paper, or labels using only a standard personal computer, printer and Internet connection. Our service currently supports a variety of USPS mail classes. Customers can also add to their mail pieces USPS Special Services such as USPS Tracking ${ }^{\text {TM }}$, Signature Confirmation ${ }^{\text {TM }}$, Registered Mail, Certified Mail, Insured Mail, Return Receipt, Collect on Delivery and Restricted Delivery. Our customers can print postage (1) on NetStamps® labels, which can be used just like regular stamps, (2) directly on envelopes, postcards or on other types of mail or labels, in a single step process that saves time and provides a professional look, (3) on plain 8.5 " x 11 " paper or on special labels for packages, and (4) on integrated customs forms for international mail and packages.

For added convenience, our mailing and shipping services incorporate address verification technology that verifies each destination address for mail sent using our service against a database of all known addresses in the United States. Our mailing and shipping service is also integrated with common small business and productivity software applications such as word processing, contact and address management, and accounting and financial applications. We also offer several different versions of NetStamps labels, such as Themed NetStamps labels and Photo NetStamps labels, which allow customers to add stock or custom designs to their postage label.

We offer multiple mailing and shipping service plans with different features and capabilities targeted to meet different customer needs. Our Pro Plan offers a basic set of Stamps.com mailing and shipping features with single-user capability. Our Premier plan, typically targeted at larger small businesses, adds multiple-user functionality, automated Certified Mail forms, additional reference codes and higher allowable postage balances as compared to our Pro Plan feature set. Our Professional Shipper plan is typically targeted at higher volume shippers such as fulfillment houses, retailers and e-commerce merchants and features direct integration into a customer's order databases, faster label printing speed, the ability to customize and save shipping profiles, and integrations with many of the industry's leading shipping management systems. We have launched shipping integrations with several of these e-commerce focused companies. Our Enterprise plan is typically targeted at organizations with multiple geographic locations and features enhanced reporting that allows a central location, such as a corporate headquarters greater visibility and control over postage expenditures across their network of locations.

Customers typically pay us a monthly service fee ranging from $\$ 15.99$ to $\$ 39.99$ depending on the service plan. In certain circumstances, customers may be on a plan where they do not owe us any monthly service fees. We have an arrangement with the USPS under which if a customer or integration partner prints a certain amount of domestic or international Priority Mail or Priority Mail Express postage, the USPS compensates us directly and the customer can qualify to have their service fees waived or refunded. In addition, we also have plans with service fees less than $\$ 15.99$ which offer more limited functionality and are targeted at retaining customers who print a lower volume of postage.

Multi Carrier Shipping Services. We offer multi carrier shipping solutions through our ShipStation and ShipWorks brands as a result of our acquisitions. The ShipStation and ShipWorks platforms offer leading solutions for medium - and high volume shippers such as warehouses, fulfillment houses, e-commerce shippers, large retailers, and other types of high volume shippers that may need more than just the USPS for their business.

Mailing and Shipping Integrations. As part of our mailing and shipping services, we offer back-end integration solutions where we provide the electronic postage for transactions to partners who manage the front-end process. Our software integrates directly into the most popular e-commerce platforms, allowing web store managers to completely automate their order fulfillment process by processing, managing, and shipping orders from virtually any e-commerce source through a single interface without manual data entry. Managers can retrieve order data and print complete shipping labels for all USPS mail classes, including First Class International®.

## Table of Contents

We have an integration partnership with Amazon.com that makes our domestic and international shipping labels available to Amazon.com Marketplace users. The service allows customers to automatically pay for postage using their Marketplace Payments account, to set a default ship-from address so they do not have to type or write it for each shipment, and to automatically populate the ship-to address on the label. Domestic and international mail classes are supported and Marketplace users may request carrier pickup from the USPS. A transaction fee per shipping label printed is charged to merchants who are not Stamps.com subscription customers. In October 2012, Amazon.com launched their own internally developed Marketplace USPS shipping solution system that resulted in a reduction in postage printed through our solution. Amazon's shipping solution is utilized by merchants for certain mail classes while our shipping solution is utilized by merchants for the other mail classes. In addition, we continue to provide the integrated Amazon.com Marketplace solution to Stamps.com subscription customers.

We have an integration partnership with the USPS where we provide electronic postage for shipping transactions generated by Click-N-Ship®, a web-based service available at USPS.com that allows USPS customers to purchase and print shipping labels for domestic and international Priority Mail and Priority Mail Express packages at no additional mark-up over the cost of postage.

In addition, ShipStation and ShipWorks offer integrations with shopping carts and online marketplaces as part of their multi-carrier shipping solutions.

Mailing \& Shipping Supplies Store. Our Mailing \& Shipping Supplies Store (our "Supplies Store") is available to our customers from within our mailing and shipping software and sells NetStamps labels, shipping labels, other mailing labels, dedicated postage printers, scales, and other mailing and shipping-focused office supplies. Our Supplies Store features a store catalog, messaging regarding our free or discounted shipping promotions, cross-selling product recommendations during the checkout process, product search capabilities, and same-day shipping of orders with expedited shipping options.

Branded Insurance. We offer Stamps.com branded insurance to our customers so that they may insure their mail or packages in a fully integrated, online process that eliminates any trips to the post office or the need to complete any -special forms. Our branded insurance is provided in partnership with Parcel Insurance Plan and is underwritten by Fireman's Fund. In addition, ShipStation and ShipWorks also offer branded package insurance as part of their offerings.

## PhotoStamps

PhotoStamps is a patented form of postage that allows consumers to turn digital photos, designs or images into valid USPS-approved postage. With this product, individuals or businesses can create customized USPS approved postage using pictures of their children, pets, vacations, celebrations, business logos and more. PhotoStamps can be used as regular postage to send letters, postcards or packages. The product is available via our separately-marketed website at www.photostamps.com. Customers upload a digital photograph or image file, customize the look and feel by choosing a border color to complement the photo, select the value of postage, and place the order online. Each sheet includes 20 individual PhotoStamps, and orders arrive via U.S. Mail in a few business days.

## Acquisition

On March 22, 2015, we entered into a definitive agreement to acquire Endicia, a wholly owned subsidiary of Newell Rubbermaid, for an aggregate purchase price of $\$ 215$ million in cash. Endicia is based in Palo Alto, California and is a leading provider of high volume shipping services, technologies and solutions for use with the USPS and other postal partners. This transaction is expected to close five business days after the completion of the customary closing conditions including regulatory approval. We are currently in the regulatory review process and the timing of that process is uncertain. We intend to fund the transaction with cash on hand and committed financing of up to $\$ 165$
million, which we have secured from three leading banks. See Note 2 - "Endicia Acquisition" in our Notes to Consolidated Financial Statement for additional information regarding this transaction.

## Table of Contents

Mailing and Shipping Business References
When we refer to our "Mailing and shipping business", we are referring to our Mailing and Shipping Services and Integrations, Mailing \& Shipping Supplies Store, Branded Insurance offering and Multi Carrier Services. We do not include our PhotoStamps business when we refer to our mailing and shipping business.

When we refer to our "Core mailing and shipping business", we are referring to the portion of our mailing and shipping business targeting our small business, enterprise and high volume shipping customers acquired through our Core mailing and shipping marketing channels which include partnerships, online advertising, direct mail, direct sales, traditional media advertising and others.

When we refer to our "Non-Core mailing and shipping business", we are referring to the portion of our mailing and shipping business that targets a more consumer oriented customer through the online enhanced promotion marketing channel. In the online enhanced promotion marketing channel, we work with various companies to advertise our service in a variety of sites on the Internet. These companies typically offer an additional promotion (beyond what we typically offer) directly to the customer in order to get the customer to try our service and we find that this channel attracts more consumer oriented customers.

When we refer to our "Mailing and shipping revenue", we are referring to our service, product and insurance revenue generated by all of our mailing and shipping customers.

When we refer to our "Core mailing and shipping revenue", we are referring to the portion of the service, product and insurance revenue that was generated by customers who were acquired through our Core mailing and shipping marketing channels.

When we refer to our "Non-Core mailing and shipping revenue", we are referring to the portion of the service, product and insurance revenue that was generated by customers who were acquired through our online enhanced promotion marketing channel. Within our mailing and shipping business, we believe it is useful to discuss our Core mailing and shipping business separately from our Non-Core mailing and shipping business because each business targets and typically serves different customer segments and utilizes different marketing channels to acquire those customers. As a result of these differences, the Core and Non-Core mailing and shipping businesses typically experience different customer and financial metrics results and trends which are best discussed separately from each other.

## Results of Operations

Total revenue in the second quarter of 2015 was $\$ 48.4$ million, an increase of $41 \%$ from $\$ 34.3$ million in the second quarter of 2014. Total revenue during the six months ended June 30, 2015 was $\$ 92.4$ million, an increase of $37 \%$ from $\$ 67.6$ million in the six months ended June 30, 2014. Mailing and shipping revenue, which includes service revenue, product revenue and insurance revenue, was $\$ 47.3$ million in the second quarter of 2015, an increase of $44 \%$ from $\$ 32.9$ million in the second quarter of 2014 and was $\$ 90.3$ million in the six months ended June 30, 2015, an increase of $39 \%$ from $\$ 65.2$ million in the six months ended June 30, 2014. PhotoStamps revenue in the second quarter of 2015 was $\$ 1.1$ million, a decrease of $21 \%$ from $\$ 1.4$ million in the second quarter of 2014 and was $\$ 2.1$ million in the six months ended June 30 , 2015, a decrease of $14 \%$ from $\$ 2.4$ million in the six months ended June 30, 2014.

The following table sets forth the breakdown of revenue for the three and six months ended June 30, 2015 and 2014 and the resulting percentage change (revenue in thousands):

Three months ended June
30 ,
Six months ended June 30,

|  | $\%$ |  |  |  |  |  | $\%$ |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2015 | 2014 | Change | 2015 | 2014 | Change |  |  |  |  |  |
| Service revenue | $\$ 40,378$ | $\$ 26,921$ | 50 | $\%$ | $\$ 76,027$ | $\$ 52,564$ | 45 | $\%$ |  |  |  |
| Product revenue | 4,270 | 3,955 | 8 | $\%$ | 9,013 | 8,568 | 5 | $\%$ |  |  |  |
| Insurance revenue | 2,631 | 2,047 | 29 | $\%$ | 5,293 | 4,040 | 31 | $\%$ |  |  |  |
| Mailing and shipping revenue | $\$ 47,279$ | $\$ 32,923$ | 44 | $\%$ | $\$ 90,333$ | $\$ 65,172$ | 39 | $\%$ |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | $\$ 1,072$ | $\$ 1,359$ | $(21$ | $\%)$ | $\$ 2,061$ | $\$ 2,408$ | $(14$ | $\%)$ |  |  |  |
| PhotoStamps revenue | 9 | 2 | 350 | $\%$ | 18 | 2 | 800 | $\%$ |  |  |  |
| Other revenue | $\$ 48,360$ | $\$ 34,284$ | 41 | $\%$ | $\$ 92,412$ | $\$ 67,582$ | 37 | $\%$ |  |  |  |

## Table of Contents

The following table sets forth the breakdown of mailing and shipping revenue, which includes Core mailing and shipping revenue and Non-Core mailing and shipping revenue and the resulting percent change for the periods indicated (revenue in thousands):


The increase in Core mailing and shipping revenue was driven by both an increase in average revenue per paid customer and an increase in paid customers. The average monthly revenue per paid customer in the second quarter of 2015 was $\$ 28.17$, an increase of $28 \%$ compared to $\$ 21.92$ in the second quarter of 2014 . Paid customers in the second quarter of 2015 were approximately 554,000 , an increase of $13 \%$ compared to 492,000 in the second quarter of 2014. We define paid customers for the quarter as ones from whom we successfully collected service fees or otherwise earned revenue from at least once during that quarter.

The following table sets forth the growth in paid customers and average quarterly revenue per paid customer for our Core mailing and shipping business:

|  | Three months ended June |  |  |  |
| :--- | :---: | :--- | :--- | :--- |
|  | 30, |  | $\%$ |  |
|  | 2015 | 2014 | Change |  |
| Paid customers for the quarter (000s) | 554 | 492 | 13 | $\%$ |
| Average quarterly revenue per paid customer | $\$ 84.51$ | $\$ 65.76$ | 28 | $\%$ |
| Core mailing and shipping revenue (000s) | $\$ 46,838$ | $\$ 32,379$ | 45 | $\%$ |

The increase in paid customers during the quarter was primarily driven by (1) a higher number of Stamps.com new paid customers compared to the prior year as a result of our increased activity and spending in Core mailing and shipping marketing channels, (2) the addition of new paid customers from ShipStation and ShipWorks as a result of our acquisitions in 2014, and (3) lower customer churn rates compared to the prior year.

The increase in average revenue per paid customer ("ARPU") was primarily the result of (1) the addition of new paid customers from our acquisitions of ShipStation and ShipWorks where the ARPU for those newly acquired paid customers is higher as compared to the ARPU from the existing Stamps.com small business customers and (2) growth in postage printed by shipping customers which was primarily attributable to our acquisitions of ShipStation and ShipWorks.

## Table of Contents

Revenue by Product
The following table shows our components of revenue and their respective percentages of total revenue for the periods indicated (in thousands except percentage):

|  | Three Months <br> Ended <br> June 30, |  | Six Months Ended <br> June 30, | 2014 |
| :--- | :--- | :--- | :--- | :--- |
| 2015 | 2014 | 2015 | 2014 |  |
| Total Revenues | $\$ 40,378$ | $\$ 26,921$ | $\$ 76,027$ | $\$ 52,564$ |
| Service | 4,270 | 3,955 | 9,013 | 8,568 |
| Product | 2,631 | 2,047 | 5,293 | 4,040 |
| Insurance | 1,072 | 1,359 | 2,061 | 2,408 |
| PhotoStamps | 9 | 2 | 18 | 2 |
| Other | $\$ 48,360$ | $\$ 34,284$ | $\$ 92,412$ | $\$ 67,582$ |

Revenue as a percentage of total revenues Service
Product
Insurance
PhotoStamps
Other
Total revenues

| 83.5 | $\%$ | 78.5 | $\%$ | 82.3 | $\%$ | 77.8 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 8.8 | $\%$ | 11.5 | $\%$ | 9.8 | $\%$ | 12.7 | $\%$ |
| 5.4 | $\%$ | 6.0 | $\%$ | 5.7 | $\%$ | 6.0 | $\%$ |
| 2.2 | $\%$ | 4.0 | $\%$ | 2.2 | $\%$ | 3.5 | $\%$ |
| 0 | $\%$ | 0 | $\%$ | 0 | $\%$ | 0 | $\%$ |
| 100 | $\%$ | 100 | $\%$ | 100 | $\%$ | 100 | $\%$ |

Our revenue is derived primarily from five sources: (1) service and transaction revenues related to our mailing and shipping services; (2) product revenue from the direct sale of consumables and supplies through our Supplies Store; (3) package insurance revenue from our branded insurance offerings; (4) PhotoStamps revenue from the sale of PhotoStamps postage labels; and (5) other revenue, consisting of advertising revenue derived from advertising programs with our existing customers.

Service revenue increased $50 \%$ to $\$ 40.4$ million in the second quarter of 2015 from $\$ 26.9$ million in the second quarter of 2014 and increased $45 \%$ to $\$ 76.0$ million in the six months ended June 30, 2015 from $\$ 52.6$ million in the six months ended June 30, 2014. The $50 \%$ increase in service revenue during the second quarter of 2015 consisted of a $51 \%$ increase in service revenue from our Core mailing and shipping business while the service revenue from our Non-Core mailing and shipping business decreased $18 \%$. The $51 \%$ increase in our Core mailing and shipping service revenue during the second quarter of 2015 consisted of a $13 \%$ increase in paid customers and a $34 \%$ increase in average service revenue per customer. The $45 \%$ increase in service revenue during the six months ended June 30, 2015 consisted of a $46 \%$ increase in service revenue from our Core mailing and shipping business while the service revenue from our Non-Core mailing and shipping business decreased $16 \%$.

Product revenue increased $8 \%$ to $\$ 4.3$ million in the second quarter of 2015 from $\$ 4.0$ million in the second quarter of 2014 and increased $5 \%$ to $\$ 9.0$ million in the six months ended June 30,2015 from $\$ 8.6$ million in the six months ended June 30, 2014. The increase is primarily attributable to an increase in sales of mailing and shipping labels and label printers as we continue to grow our customer base. Postage printed typically helps drive sales of consumables supplies such as labels. Total postage printed by customers using our service was $\$ 548$ million and $\$ 371$ million during the second quarter of 2015 and 2014, respectively, and increase of $48 \%$. Postage printed by customers was $\$ 1.1$ billion and $\$ 762$ million during the six months ended June 30, 2015 and 2014, respectively, an increase of $45 \%$.

Insurance revenue increased $29 \%$ to $\$ 2.6$ million in the second quarter of 2015 from $\$ 2.0$ million in the second quarter of 2014 and increased $31 \%$ to $\$ 5.3$ million in the six months ended June 30,2015 from $\$ 4.0$ million in the six months ended June 30, 2014. The increase in insurance revenue was primarily attributable to our recent acquisitions whose

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solutions target shipping customers who are more likely than mailing customers to purchase insurance.
PhotoStamps revenue decreased $21 \%$ to $\$ 1.1$ million in the second quarter of 2015 from $\$ 1.4$ million in the second quarter of 2014 and decreased $14 \%$ to $\$ 2.1$ million in the six months ended June 30, 2015 from $\$ 2.4$ million in the six months ended June 30, 2014. The decrease in revenue is primarily attributable to our decreased marketing efforts and expenditures on the PhotoStamps business compared to our Mailing and Shipping business.

22

## Table of Contents

Total PhotoStamps sheets shipped was approximately 69,000 in the second quarter of 2015, a $27 \%$ decrease compared to 95,000 in the second quarter of 2014 and was 122,000 in the six months ended June 30, 2015, a decrease of $21 \%$ compared to 155,000 in the six months ended June 30, 2014. Average revenue per sheet shipped increased $9 \%$ in the second quarter of 2015 to $\$ 15.6$ from $\$ 14.3$ in the second quarter of 2014 and increased $9 \%$ in the six months ended June 30, 2015 to $\$ 16.9$ from $\$ 15.6$ in the six months ended June 30, 2014. The decrease in sheets shipped was attributable to both decreased website orders as well as a decrease in high volume business orders which can fluctuate from period to period. The increase in average revenue per sheet shipped was primarily attributable to a price increase on our PhotoStamps offering.

Other revenue consists of commissions from the advertising or sale of products by third party vendors to our customer base was approximately $\$ 9,000$ and $\$ 2,000$ in the second quarter of 2015 and 2014, respectively and was approximately $\$ 18,000$ and $\$ 2,000$ during the six months ended June 30, 2015 and 2014, respectively. Commission revenue from the advertising or sale of products by third party vendors is currently not material to our consolidated financial statements.

## Cost of Revenues

The following table shows cost of revenues and cost of revenues as a percentage of its associated revenue for the periods indicated (in thousands except percentage):

|  | Three Months |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Ended June 30, 2015 |  | Six Months Ended June 30, |  |  |
|  |  |  |  |  |  |
|  |  | 2014 | 2015 |  | 2014 |
| Cost of Revenues |  |  |  |  |  |
| Service | \$6,695 | \$4,449 | \$12,966 |  | \$8,818 |
| Product | 1,435 | 1,292 | 3,036 |  | 2,834 |
| Insurance | 927 | 717 | 1,850 |  | 1,405 |
| PhotoStamps | 881 | 1,158 | 1,711 |  | 2,004 |
| Total cost of revenues | \$9,938 | \$7,616 | \$19,563 |  | \$15,061 |
| Cost as percentage of associated revenues |  |  |  |  |  |
| Service | 16.6 \% | 16.5 | 17.1 | \% | 16.8 \% |
| Product | 33.6 \% | 32.7 | 33.7 | \% | 33.1 \% |
| Insurance | 35.2 \% | 35.0 | 35.0 | \% | 34.8 \% |
| PhotoStamps | 82.2 \% | 85.2 | 83.0 | \% | 83.2 \% |
| Total cost as a percentage of total revenues | 20.6 \% | 22.2 | 21.2 | \% | 22.3 \% |

Cost of service revenue principally consists of the cost of customer service, certain promotional expenses, system operating costs, credit card processing fees and customer misprints that do not qualify for reimbursement from the USPS. Cost of product revenue principally consists of the cost of products sold through our Mailing \& Shipping Supplies Store and the related costs of shipping and handling. The cost of insurance revenue principally consists of parcel insurance offering costs. Cost of PhotoStamps revenue principally consists of the face value of postage, customer service, image review costs, and printing and fulfillment costs.

Cost of service revenue increased $50 \%$ to $\$ 6.7$ million in the second quarter of 2015 from $\$ 4.4$ million in the second quarter of 2014 and increased $47 \%$ to $\$ 13.0$ million in the six months ended June 30, 2015 from $\$ 8.8$ million in the six months ended June 30, 2014. The increase, both during the second quarter of 2015 and six months ended June 30, 2015, is primarily attributable to higher customer service costs to support our growing customer base, higher promotional expense and higher variable costs associated with our growth in revenue. Promotional expense, which represents a material portion of total cost of service revenue, is expensed in the period in which a customer qualifies
for the promotion while the revenue associated with the acquired customer is earned over the customer's lifetime. As a result, promotional expense for newly acquired customers may exceed the revenue earned from those customers in that period. Promotional expense was approximately $\$ 906,000$ in the second quarter of 2015 , an increase of $24 \%$ from $\$ 732,000$ in the second quarter of 2014, and was approximately $\$ 2.0$ million during the six months ended June 30,2015 , an increase of $21 \%$ from $\$ 1.6$ million during the six months ended June 30, 2014. The increase in our promotional expense both during the second quarter of 2015 and during the six months ended June 30, 2015 is primarily attributable to higher customer acquisition.

Cost of product revenue increased $11 \%$ to $\$ 1.4$ million in the second quarter of 2015 from $\$ 1.3$ million in the second quarter of 2014 and increased $7 \%$ to $\$ 3.0$ million in the six months ended June 30, 2015 from $\$ 2.8$ million in the six months ended June 30, 2014. The increase in cost of product revenue both in the second quarter of 2015 and six months ended June 30, 2015 is primarily due to higher fulfillment costs as a percentage of product revenue.

## Table of Contents

Cost of insurance revenue increased $29 \%$ to $\$ 927,000$ in the second quarter of 2015 from $\$ 717,000$ in the second quarter of 2014 and increased $32 \%$ to $\$ 1.9$ million in the six months ended June 30, 2015 from $\$ 1.4$ million in the six months ended June 30, 2014. The percentage increase in cost of insurance revenue was consistent with the percentage increase in insurance revenue.

Cost of PhotoStamps revenue decreased $24 \%$ to $\$ 881,000$ in the second quarter of 2015 from $\$ 1.2$ million in the second quarter of 2014 and decreased $15 \%$ to $\$ 1.7$ million in the six months ended June 30, 2015 from $\$ 2.0$ million in the six months ended June 30, 2014. The percentage decrease in cost of PhotoStamps revenue during the three and six months ended June 30, 2015 primarily attributable to fewer PhotoStamps sheets shipped and is consistent with the decrease in PhotoStamps revenue.

## Operating Expenses

The following table outlines the components of our operating expense and their respective percentages of total revenue for the periods indicated (in thousands except percentage):


## Sales and Marketing

Sales and marketing expense principally consists of spending to acquire new customers and compensation and related expenses for personnel engaged in sales, marketing, and business development activities. Sales and marketing expense increased $18 \%$ to $\$ 12.5$ million in the second quarter of 2015 from $\$ 10.7$ million in the second quarter of 2014, and increased $21 \%$ to $\$ 26.6$ million in the six months ended June 30,2015 from $\$ 22.0$ million in the six months ended June 30, 2014. Sales and marketing spending in both the second quarter and six months ended June 30, 2015 in our Core Mailing and Shipping business increased primarily due to (1) the addition of sales and marketing expense from our ShipStation and ShipWorks acquisitions, (2) an increase in stock-based compensation expense and (3) an increase in marketing spending and activity as we continued to focus on acquiring customers in our Core Mailing and Shipping business; partially offset by a reduction in spending in our Non-Core Mailing and Shipping and PhotoStamps businesses. Ongoing marketing programs include the following: customer referral programs, customer re-marketing efforts, direct mail, online advertising, partnerships, telemarketing, and traditional advertising.

Research and Development

Research and development expense principally consists of compensation for personnel involved in the development of our services, depreciation of equipment and software and expenditures for consulting services and third party software. Research and development expense increased $54 \%$ to $\$ 4.7$ million in the second quarter of 2015 from $\$ 3.0$ million in the second quarter of 2014, and increased $51 \%$ to $\$ 9.0$ million in the six months ended June 30, 2015 from $\$ 6.0$ million in the six months ended June 30, 2014. The increase both in the second quarter 2015 and six months ended June 30, 2015 is primarily due to the addition of research and development expense from our ShipStation and ShipWorks acquisitions as well as an increase in headcount-related expenses including stock-based compensation expense to support our expanded product offerings and technology infrastructure investments.

## Table of Contents

General and Administrative

General and administrative expense principally consists of compensation and related costs for executive and administrative personnel, fees for legal and other professional services, depreciation of equipment, software and building used for general corporate purposes and amortization of intangible assets. General and administrative expense increased $139 \%$ to $\$ 12.8$ million in the second quarter of 2015 from $\$ 5.4$ million in the second quarter of 2014, and increased $115 \%$ to $\$ 20.5$ million in the six months ended June 30,2015 from $\$ 9.5$ million in the six months ended June 30, 2014. The increase both during the second quarter of 2015 and six months ended June 30, 2015 is primarily attributable to (1) the addition of general and administrative expense from our ShipStation and ShipWorks acquisitions, (2) an increase in headcount and associated related expenses and infrastructure investments to support the growth in our business, (3) an increase in stock-based compensation expense, (4) an increase in legal expenses for matters not related to our acquisitions, (5) expenses related to the signing of the definitive agreement to acquire Endicia, (6) expenses related to the regulatory review process for our proposed acquisition of Endicia and (7) an increase in the amortization of acquired intangibles also related to our acquisitions.

Contingent consideration charges

Contingent consideration charges were $\$ 13.6$ million and $\$ 24.1$ million during the three and six months ended June 30,2015 , respectively. The contingent consideration charges were attributable to the change in the fair value of our contingent consideration liability related to the acquisition of ShipStation. We did not have these charges in the three and six months ended June 30, 2014. See Note 8 - "Fair Value Measurements" in our Notes to Consolidated Financial Statement for the reconciliation of our contingent consideration liability.

## Litigation Settlement

Litigation settlement expense was $\$ 10.0$ million in both the three and six months ended June 30,2015 . The expense resulted from the settlement of our litigation with Express 1 that resolved all disputes between the parties. We did not have this charge during the three and six months ended June 30, 2014. See Note 3 - "Commitments and Contingencies" in our Notes to Consolidated Financial Statements for further description.

Interest and Other (Loss) Income, Net

Interest and other (loss) income, net primarily consists of interest income from cash equivalents, short-term and long-term investments and rental (loss) income from our corporate headquarters in El Segundo, California. Interest and other income, net decreased $116 \%$ to a loss of $\$ 14,000$ in the second quarter of 2015 from an income of $\$ 89,000$ in the second quarter of 2014 , and decreased $76 \%$ to an income of $\$ 55,000$ in the six months ended June 30, 2015 from an income $\$ 225,000$ in the six months ended June 30, 2014. The decrease, both during the second quarter and six months ended June 30, 2015 is primarily due to (1) lower yields on our investment balances including certain investments in our portfolio that matured and were replaced with lower yield investments and (2) lower rental income.

## Provision for Income Taxes

We recognized income tax benefits of approximately $\$ 4.7$ million and $\$ 5.9$ million during the three and six months ended June 30, 2015, respectively. Our income tax benefits during the three and six months ended June 30, 2015 was primarily attributable to our pre-tax loss and deferred income taxes. Our actual effective tax rate during the three and six months ended June 30, 2015 differs from statutory federal rate as a result of several factors, including non-temporary differences and state and local income taxes. We recognized income tax benefits of approximately $\$ 3.5$ million and $\$ 3.3$ million during the three and six months ended June 30, 2014, which consisted of federal and state alternative minimum taxes offset by a partial release of our valuation allowance.

## Table of Contents

On June 10, 2014 we completed our acquisition of ShipStation. On August 29, 2014 we completed our acquisition of ShipWorks. Based on these discrete events, we re-evaluated our forecast of our projected taxable income. As a result, we released a portion of our valuation allowance totaling approximately $\$ 3.6$ million and $\$ 345,000$ during the second and third quarters of 2014, respectively. After analyzing our deferred tax assets including our remaining tax loss carry-forward and completing our forecast of future income taking into consideration potential synergy of the acquisitions, we believed we met the more likely than not threshold that we will be able to utilize our remaining tax loss carry-forward in the foreseeable future. As a result we released the remaining valuation allowance of approximately $\$ 9.6$ million during the fourth quarter of 2014. As of June 30, 2015 and December 31, 2014, we do not have any valuation allowance against our net deferred tax assets.

## Liquidity and Capital Resources

As of June 30, 2015 and December 31, 2014, we had approximately $\$ 91$ million and $\$ 58$ million, respectively, in cash, cash equivalents and short-term and long-term investments. We invest available funds in short-term and long-term securities, including money market funds, corporate bonds, asset backed securities, and US government and agency bonds, and do not engage in hedging or speculative activities.

Net cash provided by operating activities was $\$ 26.4$ million and $\$ 26.9$ million during the six months ended June 30, 2015 and 2014, respectively. The change in net cash provided by operating activities in 2015 compared to 2014 was primarily attributable to changes in our operating assets and liabilities.

Net cash provided in investing activities was $\$ 2.7$ million during the six months ended June 30, 2015. Net cash used in investing activities was $\$ 48.7$ million during the six months ended June 30, 2014. The change in 2015 compared to 2014 was primarily attributable to the use of cash for the acquisitions in 2014 which did not occur in 2015.

Net cash provided in financing activities was $\$ 7.7$ million during the six months ended June 30, 2015 and net cash used in financing activities was $\$ 11.1$ million during the six months ended June 30 , 2014. The change was primarily attributable to the increase in cash proceeds from the exercise of stock options in 2015 compared to 2014 and to the use of cash to repurchase our common stock in 2014 which did not occur in 2015.

We believe our available cash and marketable securities, together with the cash flow from operations, will be sufficient to fund our business for at least the next twelve months.

There have been no material changes to our contractual obligations and commercial commitments included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2014.

Updated Expectations for 2015
As of the date of the filing of this Quarterly Report, we expect the following trends for 2015:
-We expect 2015 revenue to be in a range of between $\$ 170$ million to $\$ 190$ million.
We expect 2015 Core mailing and shipping revenue to be up between $20 \%$ to $30 \%$ compared to 2014. Our ability to grow our Core mailing and shipping revenue is partly dependent on our ability to increase our small business -customer acquisition spending on marketing programs resulting in the addition of new customers. To the extent we are not able to achieve our target increase in spending, as outlined below, this would negatively impact our 2015 Core mailing and shipping revenue growth expectations.

We expect Non-Core mailing and shipping revenue to continue to be down in 2015 compared to 2014 consistent with historical trends as we continue to minimize our investments in these areas.

We expect PhotoStamps revenue to be down in 2015 compared to 2014 as we expect to continue to minimize -investments in these areas of our business and it may be challenging to repeat the same level of high volume business orders in 2015 as we achieved in 2014.

We are targeting small business customer acquisition spending including ShipStation and ShipWorks to be up $10 \%$ to - $20 \%$ in 2015 compared to 2014. We will continue to monitor our customer metrics and the state of the economy and adjust our level of spending accordingly.

Customer acquisition spending is expensed in the period incurred while the revenue and profits associated with the -acquired customer is earned over the customer's lifetime. As a result, increased customer acquisition spending in future periods could result in a reduction in operating profit and cash flow compared to past periods.

26

## Table of Contents

We expect research and development expenses to be higher in 2015 as compared to 2014 reflective of the year-over-year increases experienced in the six months ended June 30, 2015.

We expect general and administrative expenses to be higher in 2015 as compared to 2014 reflective of the year-over-year increases experienced in the six months ended June 30, 2015.
-We expect 2015 capital expenditures for the business to be approximately $\$ 3.0$ - $\$ 3.5$ million.
As discussed above, our expectations are subject to substantial uncertainty and our results are subject to macro-economic factors and other factors which could cause these trends to be worse than our current expectation or which could cause actual results to be materially different than our current expectations. These expectations are "forward looking statements", are made only as of the date of this Report and are subject to the qualification and limitations on the forward-looking statements discussion on page 17 of Part I of this Report. Our business has grown through acquisition during 2014; however the expectations above do not assume any future acquisitions or dispositions, any of which could have a significant impact on our current expectations. As described in our forward-looking statements discussion, we do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Report.

## Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations is based on our unaudited financial statements. The preparation of these financial statements is based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and notes. Except as noted below, for more information regarding our critical accounting estimates and policies, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies and Judgments" of our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 16, 2015.

## SPECIAL NOTICE REGARDING PURCHASES OF MORE THAN 5\% OF OUR STOCK

We currently have federal and state net operating loss ("NOL") carry-forwards. Under Internal Revenue Code Section 382 rules, if a "change of ownership" is triggered, our NOL asset may be impaired. A change in ownership can occur whenever there is a shift in ownership by more than 50 percentage points by one or more " $5 \%$ shareholders" within a three-year period.

Under our certificate of incorporation, any person, company or investment firm that wishes to become a " $5 \%$ shareholder" (as defined in our certificate of incorporation) must first obtain a waiver from our board of directors. In addition, any person, company or investment firm that is already a " $5 \%$ shareholder" of ours cannot make any additional purchases of our stock without a waiver from our board of directors. The NOL protective provisions contained in our certificate of incorporation (the "NOL Protective Measures") are more specifically described in our Definitive Proxy filed with the Securities and Exchange Commission on April 2, 2008.

On July 22, 2010, our board of directors suspended the NOL Protective Measures by approving a waiver from the NOL Protective Measures to all persons and entities, including companies and investment firms. As a result, our stockholders are now allowed to become " $5 \%$ shareholders" and existing " $5 \%$ shareholders" are allowed to make additional purchases of our stock each without having to comply with the restrictions contained in the NOL Protective Measures. This waiver may be revoked by our board of directors at any time if the board deems the revocation necessary to protect against a Section 382 "change of ownership" that would limit our ability to utilize future NOLs. For complete details about this waiver from the NOL Protective Measures, please see our Form 8-K filed on July 28, 2010.

As of July 31, 2015, we had approximately 16.5 million shares outstanding, and therefore ownership of approximately 824,000 shares or more would currently constitute a " $5 \%$ shareholder". We strongly urge that any stockholder contemplating becoming a $5 \%$ or more shareholder contact us before doing so.

## Table of Contents <br> ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We have not used derivative financial instruments in our investment portfolio. None of the instruments in our investment portfolio are held for trading purposes. Our cash equivalents and investments consist of money market, U.S. government obligations, asset-backed securities and public corporate debt securities with weighted average maturities of 240 days at June 30, 2015. Our cash equivalents and investments approximated $\$ 91$ million and had a weighted average interest rate of $0.7 \%$. Interest rate fluctuations impact the carrying value of the portfolio. The fair value of our portfolio of marketable securities would not be significantly affected by either a $10 \%$ increase or decrease in the rates of interest due primarily to the short-term nature of the portfolio. We do not believe that the future market risks related to the above securities will have a material adverse impact on our financial position, results of operations or liquidity.

As we do not have any operations outside of the United States, we are not exposed to foreign currency risks.

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act).

As of the end of the period covered by this Report, our management evaluated, with the participation of our Principal Executive Officer and Principal Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer have concluded, as of that time, that our disclosure controls and procedures were effective.

## Changes in Internal Controls

During the quarter ended June 30, 2015, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Table of Contents

## PART II - OTHER INFORMATION

## ITEM 1.LEGAL PROCEEDINGS

See Note 3 - "Commitments and Contingencies - Legal Proceedings" of our Notes to Consolidated Financial Statements, which is incorporated herein by reference.

## ITEM 1A. RISK FACTORS

Except to the extent updated below or previously updated or to the extent additional factual information disclosed elsewhere in this Quarterly Report on Form 10-Q relates to such risk factors (including, without limitation, the matters discussed in Part I, "Item 2-Management's Discussion and Analysis of Financial Condition and Results of Operations"), there were no material changes to the risk factors disclosed in Part I, "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 16, 2015.

We may expand through acquisitions of, or investments in, other companies or technologies, which may result in additional dilution to our stockholders and consume resources that may be necessary to sustain our business.

As part of our business strategy to acquire complementary services, technologies or businesses we may: -issue additional equity securities that would dilute our stockholders;

- use cash that we may need in the future to operate our business; and
- incur debt that could have terms unfavorable to us or that we might be unable to repay.

Business acquisitions also involve the risk of unknown liabilities associated with the acquired business. In addition, we may not realize the anticipated benefits of any acquisition, including securing the services of key employees. Incurring unknown liabilities or the failure to realize the anticipated benefits of an acquisition could seriously harm our business.

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

Issuer Purchases of Equity Securities
We did not purchase any of our common stock during the second quarter of 2015.

Period


May 31, 2015
June 1, 2015 -
June 30, $2015 \quad-\quad-\quad$ - \$ 37,150
On October 29, 2014, our Board of Directors approved a new share repurchase program that replaces all prior repurchase programs and authorizes the Company to repurchase up to 1.0 million shares of stock during the next twelve months.

We will consider repurchasing stock in the future by evaluating such factors as the price of the stock, the daily trading volume and the availability of large blocks of stock and any additional constraints related to material inside information we may possess. Our repurchase of any of our shares will be subject to limitations that may be imposed on such repurchases by applicable securities laws and regulations and the rules of The NASDAQ Stock Market. Repurchases may be made in the open market, or in privately negotiated transactions from time to time at our discretion. We have no commitment to make any repurchases.

29

Table of Contents
ITEM 3. DEFAULTS UPON SENIOR SECURITIES
None.
ITEM 4. MINE SAFETY DISCLOSURES
Not applicable.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. *
32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act
of 2002 . $^{*}$
101.INS XBRL Instance Document
101.SCHXBRL Taxonomy Extension Schema Document
101.CALXBRL Taxonomy Extension Calculation Linkbase Document 101.DEFXBRL Taxonomy Extension Definition Linkbase Document
101.LAB XBRL Taxonomy Extension Label Linkbase Document
101.PREXBRL Taxonomy Extension Presentation Linkbase Document
*Furnished, not filed.
30

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

STAMPS.COM INC.
(Registrant)
August 7, 2015 By:/s/ KEN MCBRIDE
Ken McBride
Chairman and Chief
Executive Officer
August 7, 2015 By:/s/ KYLE HUEBNER
Kyle Huebner
Co-President and Chief
Financial Officer

31

