

STAMPS.COM INC
Form 10-Q
August 08, 2018

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, 2018

OR

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

For the transition period from _____ to _____

Commission file number: 000-26427

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 Avenue

El Segundo, California 90245

(Address of Principal Executive Offices and 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, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 31, 2018, there were 18,154,722 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, 2018

TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	<u>1</u>
ITEM 1. <u>FINANCIAL STATEMENTS</u>	<u>1</u>
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>16</u>
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>30</u>
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	<u>30</u>
<u>PART II - OTHER INFORMATION</u>	<u>30</u>
ITEM 1. <u>LEGAL PROCEEDINGS</u>	<u>30</u>
ITEM 1A. <u>RISK FACTORS</u>	<u>30</u>
ITEM 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>34</u>
ITEM 3. <u>DEFAULTS UPON SENIOR SECURITIES</u>	<u>34</u>
ITEM 4. <u>MINE SAFETY DISCLOSURES</u>	<u>34</u>
ITEM 5. <u>OTHER INFORMATION</u>	<u>34</u>
ITEM 6. <u>EXHIBITS</u>	<u>35</u>

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, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 282,868	\$ 153,903
Accounts receivable, net	67,437	80,797
Current income taxes	23,204	22,344
Other current assets	16,488	14,449
Total current assets	389,997	271,493
Property and equipment, net	36,757	37,507
Goodwill	239,705	239,705
Intangible assets, net	72,984	80,990
Deferred income taxes, net	41,110	43,148
Other assets	7,783	6,261
Total assets	\$ 788,336	\$ 679,104
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 102,144	\$ 103,076
Deferred revenue	3,922	3,871
Current portion of debt, net of debt issuance costs	9,423	8,392
Total current liabilities	115,489	115,339
Long-term debt, net of debt issuance costs	55,673	60,642
Other liabilities	6,588	5,310
Total liabilities	177,750	181,291
Commitments and contingencies (Note 3)		
Stockholders' equity:		
Common stock, \$.001 par value per share		
Authorized shares: 47,500 in 2018 and 2017		
Issued shares: 32,951 in 2018 and 32,177 in 2017		
Outstanding shares: 18,151 in 2018 and 17,573 in 2017	55	55
Additional paid-in capital	1,022,608	962,227
Treasury stock, at cost, 14,800 shares in 2018 and 14,604 in 2017	(427,721)	(387,545)
Retained earnings (accumulated deficit)	15,638	(76,930)
Accumulated other comprehensive income	6	6
Total stockholders' equity	610,586	497,813
Total liabilities and stockholders' equity	\$ 788,336	\$ 679,104

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

Table of ContentsSTAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Service	\$125,206	\$102,685	\$246,122	\$195,105
Product	4,892	4,763	10,571	10,477
Insurance	4,293	4,393	8,661	8,833
Customized postage	5,218	4,276	7,798	6,718
Other	18	23	40	47
Total revenues	139,627	116,140	273,192	221,180
Cost of revenues (exclusive of amortization of intangible assets, which is included in general and administrative expense):				
Service	22,610	12,726	43,259	25,402
Product	1,480	1,593	3,231	3,395
Insurance	1,014	1,213	2,012	2,581
Customized postage	4,338	3,557	6,467	5,449
Total cost of revenues	29,442	19,089	54,969	36,827
Gross profit	110,185	97,051	218,223	184,353
Operating expenses:				
Sales and marketing	25,789	22,280	51,537	45,430
Research and development	12,340	11,628	24,413	22,150
General and administrative	25,187	21,451	46,203	40,433
Total operating expenses	63,316	55,359	122,153	108,013
Income from operations	46,869	41,692	96,070	76,340
Interest expense	(650)	(932)	(1,240)	(1,812)
Interest and other income	43	159	92	189
Income before income taxes	46,262	40,919	94,922	74,717
Income tax expense	738	9,879	2,354	10,539
Net income	\$45,524	\$31,040	\$92,568	\$64,178
Net income per share:				
Basic	\$2.53	\$1.83	\$5.19	\$3.79
Diluted	\$2.41	\$1.71	\$4.95	\$3.54
Weighted average shares outstanding:				
Basic	18,015	16,930	17,830	16,916
Diluted	18,906	18,125	18,709	18,147

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

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$45,524	\$31,040	\$92,568	\$64,178
Other comprehensive loss, net of tax:				
Unrealized loss on investments	(1)	(2)	—	(4)
Comprehensive income	\$45,523	\$31,038	\$92,568	\$64,174

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

Table of ContentsSTAMPS.COM INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 30,	2017
	2018	
Operating activities:		
Net income	\$ 92,568	\$ 64,178
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,614	10,626
Stock-based compensation expense	17,439	22,335
Deferred income tax expense	2,038	5,838
Accretion of debt issuance costs	186	186
Changes in operating assets and liabilities, net of assets and liabilities acquired:		
Accounts receivable	13,360	(3,140)
Other current assets	(2,039)	(10,107)
Current income taxes	(860)	—
Other assets	(1,522)	(1,621)
Deferred revenue	51	(7)
Other liabilities	1,278	—
Accounts payable and accrued expenses	3,240	(9,799)
Net cash provided by operating activities	136,353	78,489
Investing activities:		
Sale of short-term investments	—	1,502
Sale of long-term investments	—	10
Purchase of long-term investments	—	(4)
Acquisition of property and equipment	(1,223)	(4,360)
Net cash used in investing activities	(1,223)	(2,852)

Financing activities:				
Proceeds from short term financing obligation, net of repayments	(664))	(524))
Principal payments on term loan	(4,124))	(3,094))
Payment on revolving credit facility	—		(10,000))
Proceeds from exercise of stock options	40,962		28,641	
Issuance of common stock under Employee Stock Purchase Plan	1,981		1,469	
Repurchase of common stock	(40,176))	(87,919))
Payments related to tax withholding for share-based compensation	(4,144))	(799))
Net cash used in financing activities	(6,165))	(72,226))
Net increase in cash and cash equivalents	128,965		3,411	
Cash and cash equivalents at beginning of period	153,903		106,932	
Cash and cash equivalents at end of period	\$ 282,868		\$ 110,343	
Supplemental information:				
Capital expenditures accrued but not paid at period end	\$ 65		\$ 376	
Tenant improvement allowance	\$ 600		\$ 848	

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

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(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 consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in our latest annual report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on February 28, 2018.

In our opinion, these unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly our financial position as of June 30, 2018, our results of operations for the three and six months ended June 30, 2018, and our cash flows for the six months ended June 30, 2018. The results of operations for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018.

Basis of Consolidation

The consolidated financial statements include all the assets, liabilities, revenues, expenses and cash flows of Stamps.com Inc. and the entities in which we have 100% voting and/or economic control, which includes Auctane LLC (ShipStation), Interapptive, Inc. (ShipWorks), PSI Systems Inc. (Endicia), ShippingEasy Group, Inc. (ShippingEasy) and PhotoStamps Inc. In July 2016, we completed our acquisition of 100% of the outstanding shares of ShippingEasy. Please see Note 2 - "Acquisitions" in our Notes to Consolidated Financial Statements for further description.

Intercompany accounts and transactions between consolidated entities have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates, and such differences may be material to the consolidated financial statements. Significant estimates and judgments inherent in the preparation of the consolidated financial statements include estimates of loss contingencies and the realizability of deferred income taxes.

Business Combinations

The acquisition method of accounting is used for business combinations. The results of operations of acquired businesses are included in our consolidated financial statements prospectively from the date of acquisition. The fair value of purchase consideration is allocated to the assets acquired and liabilities assumed from the acquired entity and is generally based on their fair value at the acquisition date. The excess of the fair value of purchase consideration over the fair value of the assets acquired and liabilities assumed is recorded as goodwill. Historically, the primary items that have generated goodwill include anticipated synergies between the acquired business and the Company and the acquired assembled workforce, neither of which qualifies for recognition as an intangible asset.

Acquisition-related expenses are recognized in our consolidated financial statements as incurred.

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Contingencies and Litigation

In the ordinary course of business, we are subject to various routine litigation matters as a claimant and a defendant. We record any amounts recovered in these matters when received. We establish loss provisions for claims against us when the loss is both probable and can be reasonably estimated. If either or both of the criteria are not met, we assess whether there is at least a reasonable possibility that a loss, or additional losses, may have been incurred. If there is a reasonable possibility that a loss or additional loss may have been incurred for such proceedings, we disclose the estimate of the amount of loss or possible range of loss, or disclose that an estimate of loss cannot be made, as applicable.

Deferred Revenue

Our deferred revenue relates mainly to service revenue, which generally arises due to the timing of payment versus the provision of services for certain customers billed in advance. Approximately \$2.4 million of revenue recognized in the six months ended June 30, 2018 was included in the deferred revenue balance at December 31, 2017.

Fair Value of Financial Instruments

Carrying amounts of certain of our financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate fair value due to their short maturities. The Company's outstanding debt held by third-party financial institutions is carried at cost, adjusted for debt issuance costs. The Company's debt is not publicly traded and the carrying amount typically approximates fair value for debt that accrues interest at a variable rate for companies with similar financial characteristics as the Company, which are considered Level 2 fair value inputs as defined in Note 8 in our Consolidated Financial Statements.

Goodwill and Indefinite-Lived 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. 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. A reporting unit is the operating segment or a business that is one level below that operating segment. Reporting units are aggregated as a single reporting unit if they have similar economic characteristics. We aggregated our reporting units into a single reporting unit because we determined they have similar economic characteristics. Goodwill is reviewed for impairment annually on October 1 utilizing either a qualitative assessment or a two-step process. We have an option to make a qualitative assessment of a reporting unit's goodwill for impairment. If we choose to perform a qualitative assessment and determine the fair value more likely than not exceeds the carrying value, no further evaluation is necessary. When we perform the two-step process, the first step requires us to compare the fair value of our reporting unit, which we primarily determine using an income approach based on the present value of discounted cash flows, to the respective carrying value, which includes goodwill. If the fair value of our reporting unit exceeds its carrying value, the goodwill is not considered impaired. If the carrying value is higher than the fair value, there is an indication that impairment may exist and the second step is required. In step two, the implied fair value of goodwill is calculated as the excess of the fair value of our reporting unit over the fair values assigned to its assets and liabilities. If the implied fair value of goodwill is less than the carrying value of our reporting unit's goodwill, the difference is recognized as an impairment loss. As of June 30, 2018, we are not aware of any indicators of impairment that would require an impairment analysis other than our annual goodwill impairment analysis. Indefinite-lived intangible assets are reviewed for impairment annually on October 1. In assessing other intangible assets not subject to amortization for impairment, the Company also has the option to perform a qualitative assessment

to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of such an intangible asset is less than its carrying amount. If the Company determines that it is not more likely than not that the fair value of such an intangible asset is less than its carrying amount, then the Company is not required to perform any additional tests for assessing those intangible assets for impairment. However, if the Company concludes otherwise or elects not to perform the qualitative assessment, then it is required to perform a quantitative impairment test that involves a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. As of June 30, 2018, we are not aware of any indicators of impairment that would require an impairment analysis other than our annual indefinite-lived intangible assets impairment analysis.

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Long-Lived Assets and Finite-Lived 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.

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. Leasehold improvements are capitalized and amortized over the shorter of the useful life of the asset or the remaining term of the lease. 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 income from operations.

Income Taxes

We account for income taxes in accordance with Financial Accounting Standards Board (FASB) ASC Topic No. 740, Income Taxes (Income Taxes), 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. Income Taxes 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 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 Income Taxes based on all available positive and negative evidence.

Revenue Recognition

We recognize revenues when we transfer control of promised goods or services to our customers in an amount that reflects the consideration to which we expect to be entitled to in exchange for those goods or services. We account for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance, and collectability of consideration is probable. Our payment terms vary by the products and services offered. The term between billings and when payment is due is not significant.

Revenues are presented on a disaggregated basis on the consolidated statements of income.

Service revenues are recognized at a point in time, as transactions are processed, or over a period of time, typically one month or less. We earn service revenue from our mailing and shipping operations in several different ways: (1) customers may pay us a monthly fee based on a subscription plan which may be waived or refunded for certain customers; (2) we may be compensated directly by the United States Postal Service (USPS) for certain qualifying customers under our USPS partnership; (3) we may earn transaction related revenue based on customers purchasing postage or printing shipping labels; (4) we may earn compensation by offering customers a discounted postage rate that is provided to the customers by our integration partners; and (5) we may earn other types of revenue shares or

other compensation from specific customers or integration partners.

Customers may purchase postage and other delivery services from the USPS and other carriers through our mailing and shipping solutions. When funds are transferred directly from customers to the carrier, these funds are not recognized as revenue. We also provide mailing and shipping services for which the cost of postage or delivery is included in the cost of the service and, therefore, is recognized as service revenue.

Product revenue consists of products sold through the mailing and shipping supplies stores which are available to our customers from within some of our mailing and shipping solutions. Products sold include shipping labels, mailing labels, dedicated postage printers, scales, and other mailing and shipping-focused office supplies. We recognize product revenue on product purchases upon delivery of the order to the customer.

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

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 providers. We recognize insurance revenue on insurance purchases upon the ship date of the insured package.

Customized postage revenue, which includes the face value of postage, from the sale of customized postage sheets and rolls is recognized upon transfer of control of the product to the customer, which occurs upon our delivery to the carrier.

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. Total revenue from such advertising arrangements was not significant during the six months ended June 30, 2018 or 2017, respectively.

Short-Term Financing Obligations

We utilize short-term financing, which is separate from our debt, to fund certain Company operations. Short-term financing obligations are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets. As of June 30, 2018, we had \$16.5 million in short-term financing obligations and \$89.0 million of unused credit. As of December 31, 2017, we had \$17.2 million in short-term financing obligations and \$103.4 million of unused credit.

Stock-Based Compensation

We account for share-based employee compensation plans under the fair value recognition and measurement provisions in accordance with applicable accounting standards, which require all share-based payments to employees, including grants of stock options and restricted stock units (RSUs), to be measured based on the grant date fair value of the awards, with the resulting expense generally recognized on a straight-line basis over the period during which the employee is required to perform service in exchange for the award.

We account for forfeitures as they occur. Prior to the adoption of ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, in 2017, share-based compensation expense was recorded net of estimated forfeitures, which were based on historical forfeitures and adjusted to reflect changes in facts and circumstances, if any.

We use the Black-Scholes-Merton option valuation model to estimate the fair value of share-based payment awards on the date of grant, which requires us to use a number of complex estimates and subjective assumptions, including stock price volatility, expected term, risk-free interest rates, and projected employee stock option exercise behaviors. 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.

Trademarks and Other Intangible Assets (excluding Goodwill)

Acquired trademarks and other intangibles (excluding goodwill) 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, which is consistent with the expected future cash flows.

Treasury Stock

During the six months ended June 30, 2018 and June 30, 2017, we repurchased approximately 174,000 shares and 730,000 shares for \$36.0 million and \$87.9 million, respectively. Also, in the first quarter of 2018 and the first quarter of 2017, we withheld 21,076 and 6,670 of shares, respectively, to satisfy income tax obligations related to performance-based inducement equity awards issued to the General Manager and the then Chief Technology Officer of ShippingEasy as described in Note 2 - "Acquisitions."

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Accounting Guidance Adopted in 2018

Definition of a Business

In January 2017, the FASB issued ASU 2017-01, guidance that changes the definition of a business for accounting purposes. Under the new guidance, an entity first determines whether substantially all of the fair value of a set of assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the set of assets is not deemed to be a business. If this threshold is not met, the entity then evaluates whether the set of assets meets the requirement to be deemed a business, which at minimum, requires there to be an input and a substantive process that together significantly contribute to the ability to create outputs. The guidance became effective on a prospective basis for the Company on January 1, 2018. The Company's adoption of the guidance on January 1, 2018 did not have a material impact on the Company's consolidated financial statements.

Modification of Share-Based Payments

In May 2017, the FASB issued ASU 2017-09, guidance that clarifies when changes to the terms and conditions of share-based awards must be accounted for as modifications. The guidance does not change the accounting treatment for modifications. The guidance became effective for the Company on January 1, 2018 and was adopted on a prospective basis. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, an updated standard on revenue recognition. This ASU superseded 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 U.S. 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, companies may be required to use more judgment and make more estimates than under current authoritative guidance.

On January 1, 2018, the Company adopted the guidance under the modified retrospective method. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

Accounting Guidance Not Yet Adopted

Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, a standard which simplifies the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance will become effective on a prospective basis for the Company on January 1, 2020 and is not expected to have a material impact on the Company's consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, a new accounting standard for leases. The new standard generally requires the recognition of financing and operating lease liabilities and corresponding right-of-use assets on the balance sheet. For financing leases, a lessee recognizes amortization of the right-of-use asset as an operating expense over the lease term separately from interest on the lease liability. For operating leases, a lessee recognizes its total lease expense as an operating expense over the lease term. The amendments are effective for the Company in the first quarter of 2019 using a modified retrospective approach with early adoption permitted. The Company is currently evaluating the impact the adoption of this standard will have on its consolidated financial statements.

Table of Contents

STAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

2. Acquisitions

We have accounted for all of our acquisitions under the acquisition method of accounting in accordance with the provisions of FASB ASC Topic No. 805, Business Combinations.

ShippingEasy Acquisition

On July 1, 2016, we completed our acquisition of ShippingEasy Group, Inc. (ShippingEasy). The net purchase price including adjustments for net working capital totaled approximately \$55.4 million and was funded from current cash and investment balances.

In connection with the acquisition, we agreed to issue performance-based inducement equity awards to the General Manager and the then Chief Technology Officer of ShippingEasy. These inducement awards cover an aggregate of up to 87,134 common shares if earnings targets for ShippingEasy are achieved over a two and one-half year period which began July 1, 2016. The awards are subject to proration if at least 75% of the applicable target is achieved and are subject to forfeiture or acceleration based on changes in employment circumstances over the performance period.

In fiscal 2016, we determined the achievement of 100% of the earnings target for the six months ended December 31, 2016 was met, therefore, we recognized approximately \$1.9 million of stock-based compensation expense, representing 21,783 shares, for these inducement equity awards during the six months ended December 31, 2016. The equity award for the first phase was issued in the first quarter of 2017 with 15,113 shares distributed and 6,670 shares withheld to satisfy income tax obligations. In fiscal 2017, we determined the achievement of 100% of the earnings target for the twelve months ended December 31, 2017 was met, therefore, we recognized approximately \$4.9 million of stock-based compensation expense, representing 56,638 shares, for these inducement equity awards during the year ended December 31, 2017. The equity award for the second phase was issued in the first quarter of 2018 with 35,562 shares distributed and 21,076 shares withheld to satisfy income tax obligations. As of the second quarter of 2018, we estimated the achievement of 100% of the earnings target for the twelve months ended December 31, 2018 is probable, therefore, we recognized approximately \$189,000 and \$379,000 of stock-based compensation expense for these inducement equity awards during the three and six months ended June 30, 2018, respectively. The \$379,000 of stock-based compensation expense recognized in the six months ended June 30, 2018 represents 50% of the total performance-based equity award for the third phase.

We also issued inducement stock option grants for an aggregate of approximately 62,000 shares of Stamps.com common stock to 48 new employees in connection with our acquisition of ShippingEasy.

3. Commitments and Contingencies

Legal Proceedings

We are subject to various routine legal proceedings and claims incidental to our business, and we do not believe that these proceedings and claims would reasonably be expected to have a material adverse effect on our financial position, results of operations, or cash flows.

On February 8, 2018, a putative class action complaint was filed against us in a case entitled Juan Lopez and Nicholas Dixon v. Stamps.com, Inc., Case No. 2:18-cv-01101, in the United States District Court for the Central District of

California, Western Division, alleging wage and hour claims on behalf of our current and former “non-exempt” hourly call center employees. The complaint sought class certification, unspecified damages, unpaid wages, penalties, restitution, interest, and attorneys’ fees and costs. On July 24, 2018, we entered into a preliminary settlement that would resolve this matter for a non-material payment to be distributed to the participating class members. This preliminary settlement remains subject to court approval.

The Company accrued an immaterial amount related to the Company's legal proceedings as of June 30, 2018. The Company had not accrued any amounts related to any of the Company’s legal proceedings as of December 31, 2017.

Although management at present believes that the ultimate outcome of the various routine 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 expectations may result in a material adverse impact on our business, results of operations, financial position, and overall trends.

Table of ContentsSTAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Commitments

The Company leases facilities pursuant to noncancelable operating lease agreements expiring through 2028. Rent expense is recognized on a straight-line basis over the lease term. Lease incentives are amortized over the lease term on a straight-line basis. Leasehold improvements are capitalized and amortized over the shorter of the useful life of the asset or the remaining term of the lease. Rent expense for the three and six months ended June 30, 2018 was approximately \$900,000 and \$1.8 million, respectively. Rent expense for the three and six months ended June 30, 2017 was approximately \$900,000 and \$1.9 million, respectively.

The following table is a schedule of our significant contractual obligations and commercial commitments (other than debt commitments), which consist of minimum operating lease payments as of June 30, 2018 (in thousands):

Twelve Month Period Ending June 30,	Operating Lease Obligations
2019	\$ 4,391
2020	4,201
2021	4,192
2022	2,999
2023	2,819
Thereafter	4,871
Total	\$ 23,473

4. Net Income per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$45,524	\$31,040	\$92,568	\$64,178
Basic - weighted average common shares	18,015	16,930	17,830	16,916
Diluted effect of common stock equivalents	891	1,195	879	1,231
Diluted - weighted average common shares	18,906	18,125	18,709	18,147
Earnings per share:				
Basic	2.53	1.83	5.19	3.79
Diluted	2.41	1.71	4.95	3.54

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

	Three	Six		
	Months	Months		
	Ended	Ended		
	June 30,	June 30,		
	2018	2017	2018	2017
Anti-dilutive stock options	67	42	81	42

Table of ContentsSTAMPS.COM INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

5. Stock-Based Compensation

Compensation expense for employee stock options granted is generally recognized using the straight-line method over their respective vesting periods of up to five years. Starting in the third quarter of fiscal 2016, our stock-based compensation expense included performance-based inducement equity awards relating to the ShippingEasy acquisition as described in Note 2 - "Acquisitions."

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

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
Stock-based compensation expense relating to:				
Stock options	\$9,507	\$10,723	\$16,698	\$21,858
Employee stock purchases	383	245	740	477
Total stock-based compensation expense	\$9,890	\$10,968	\$17,438	\$22,335
Stock-based compensation expense relating to:				
Cost of revenues	\$730	\$445	\$1,213	\$993
Sales and marketing	1,484			