CHANNELADVISOR CORP
Form 10-Q
October 28, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from to

Commission File Number 001-35940

CHANNELADVISOR CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	56-2257867 (I.R.S. Employer Identification No.)
2701 Aerial Center Parkway, Morrisville, NC (Address of principal executive offices)	27560 (Zip Code)

(919) 228-4700
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 ý 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No ý

The number of outstanding shares of the registrant's common stock, par value $0.001 per share, as of the close of business on October 18, 2013 was 21,685,852.

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Part I. FINANCIAL INFORMATION
Item 1. Financial Statements
ChannelAdvisor Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)

	September 30, 2013	December 31, 2012
	(unaudited)	
Assets		
Current assets:		
Cash	$90,287	$10,865
Accounts receivable, net of allowance of $298 and $191 as of September 30, 2013 and December 31, 2012, respectively	10,796	9,571
Prepaid expenses and other current assets	2,524	2,589
Total current assets	103,607	23,025
Property and equipment, net	7,135	4,315
Goodwill	16,106	16,106
Intangible assets, net	769	1,245
Restricted cash	686	687
Other assets	371	2,644
Total assets	$128,674	$48,022
Liabilities, redeemable convertible preferred stock and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$2,198	$1,269
Accrued expenses	5,762	4,650
Deferred revenue	14,052	9,750
Current portion of long-term debt	3,300	3,370
Other current liabilities	1,976	980
Total current liabilities	27,288	20,019
Long-term debt, net of current portion	8,051	7,602
Series A and Series C warrants liability	—	3,235
Long-term capital leases, net of current portion	1,557	1,136
Other long-term liabilities	1,632	1,714
Total liabilities	38,528	33,706
Commitments and contingencies		
Redeemable convertible preferred stock:		
Convertible Series A preferred stock, $0.001 par value, 0 and 94,069,763 shares authorized, 0 and 93,821,393 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	—	18,887
Convertible Series B preferred stock, $0.001 par value, 0 and 40,641,227 shares authorized, issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	—	18,000
Convertible Series B-1 preferred stock, $0.001 par value, 0 and 5,660,378 shares authorized, issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	—	3,000
Convertible Series C preferred stock, $0.001 par value, 0 and 80,000,000 shares authorized, 0 and 73,880,351 shares issued and outstanding as of	—	50,608

September 30, 2013 and December 31, 2012, respectively		
Total redeemable convertible preferred stock	—	90,495
Stockholders' equity (deficit):		
Common stock, $0.001 par value, 100,000,000 and 303,500,000 shares authorized, 21,672,635 and 1,240,193 shares issued and outstanding as of September 30, 2013 and December 31, 2012, respectively	21	1
Additional paid-in capital	182,104	3,584
Accumulated other comprehensive loss	(485)	(289)
Accumulated deficit	(91,494)	(79,475)
Total stockholders' equity (deficit)	90,146	(76,179)
Total liabilities, redeemable convertible preferred stock and stockholders' equity (deficit)	$128,674	$48,022

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue	$16,620	$13,020	$47,518	$37,594
Cost of revenue	4,555	3,831	12,971	10,707
Gross profit	12,065	9,189	34,547	26,887
Operating expenses:				
Sales and marketing	9,316	6,159	26,398	18,165
Research and development	2,991	2,459	8,882	7,533
General and administrative	3,499	2,088	8,641	5,862
Total operating expenses	15,806	10,706	43,921	31,560
Loss from operations	(3,741)	(1,517)	(9,374)	(4,673)
Other (expense) income:				
Interest expense, net	(520)	(407)	(2,606)	(828)
Other income, net	4	9	17	25
Total other (expense) income	(516)	(398)	(2,589)	(803)
Loss before income taxes	(4,257)	(1,915)	(11,963)	(5,476)
Income tax expense	35	43	56	83
Net loss	$(4,292)	$(1,958)	$(12,019)	$(5,559)
Net loss per share:				
Basic and diluted	$(0.20)	$(1.68)	$(1.13)	$(4.81)
Weighted average common shares outstanding:				
Basic and diluted	21,588,578	1,168,030	10,652,921	1,155,106

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Comprehensive Loss
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	$(4,292)	$(1,958)	$(12,019)	$(5,559)
Other comprehensive loss:				
Foreign currency translation adjustments	(38)	(1)	(196)	(38)
Total comprehensive loss	$(4,330)	$(1,959)	$(12,215)	$(5,597)

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statement of Changes in Stockholders' (Deficit) Equity
(in thousands, except share data)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' (Deficit) Equity
	Shares	Amount				
Balance, December 31, 2012	1,240,193	$1	$3,584	$ (289)	$(79,475)	$(76,179)
Conversion of redeemable convertible preferred stock to common stock	13,401,499	13	91,137	—	—	91,150
Conversion of redeemable convertible preferred stock warrants to common stock warrants	—	—	3,632	—	—	3,632
Issuance of common stock from initial public offering, net of issuance costs	6,612,500	7	81,981	—	—	81,988
Cashless exercise of common stock warrants	201,396	—	—	—	—	—
Exercise of stock options	217,047	—	337	—	—	337
Stock-based compensation expense	—	—	1,433	—	—	1,433
Net loss	—	—	—	—	(12,019)	(12,019)
Foreign currency translation adjustments	—	—	—	(196)	—	(196)
Balance, September 30, 2013	21,672,635	$21	$182,104	$ (485)	$(91,494)	$90,146

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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ChannelAdvisor Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities		
Net loss	$(12,019)	$(5,559)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,619	2,101
Bad debt expense	221	37
Change in fair value of preferred stock warrants	1,052	68
Accretion of debt discount	449	211
Stock-based compensation expense	1,433	393
Change in lease incentive obligation	(15)	(16)
Amortization of debt issuance costs	33	45
Change in deferred rent	126	491
Changes in assets and liabilities:		
Accounts receivable	(1,503)	(362)
Prepaid expenses and other assets	63	(322)
Restricted cash	—	153
Accounts payable and accrued expenses	2,278	(209)
Deferred revenue	4,227	3,791
Net cash (used in) provided by operating activities	(1,036)	822
Cash flows from investing activities		
Purchases of property and equipment	(1,990)	(1,841)
Payment of internal-use software development costs	(962)	(150)
Net cash used in investing activities	(2,952)	(1,991)
Cash flows from financing activities		
Proceeds from initial public offering, net of underwriting discounts and commissions	86,095	—
Proceeds from issuance of debt, net of debt issuance costs	—	4,896
Repayment of debt and capital leases	(919)	(1,160)
Payment of deferred offering costs	(2,474)	—
Proceeds from exercise of stock options	879	101
Net cash provided by financing activities	83,581	3,837
Effect of currency exchange rate changes on cash	(171)	(22)
Net increase in cash	79,422	2,646
Cash, beginning of period	10,865	4,998
Cash, end of period	$90,287	$7,644
Supplemental disclosure of cash flow information		
Cash paid for interest	$1,138	$436
Cash paid for income taxes	$89	$64
Supplemental disclosure of noncash investing and financing activities		
Conversion of redeemable convertible preferred stock to common stock	$91,150	$—
Conversion of preferred stock warrants to common stock warrants	$3,632	$—
Accretion of issuance costs on redeemable convertible preferred stock	$—	$15
Deferred offering costs included in accounts payable and accrued expenses	$108	$367
Accrued capital expenditures	$526	$—

Capital lease obligations entered into for the purchase of fixed assets	$1,454	$2,014

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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ChannelAdvisor Corporation and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

1. Description of the Business

ChannelAdvisor Corporation ("ChannelAdvisor" or the "Company") was incorporated in the state of Delaware and capitalized in June 2001. The Company began operations in July 2001. ChannelAdvisor is a provider of software-as-a-service, or SaaS, solutions that allow retailers and manufacturers to integrate, manage and monitor their merchandise sales across hundreds of online channels. The Company is headquartered in Morrisville, North Carolina and has international offices in England, Ireland, Germany, Australia, Hong Kong and Brazil.

2. Significant Accounting Policies

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Interim Condensed Consolidated Financial Information

The accompanying condensed consolidated financial statements and footnotes have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") as contained in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") for interim financial information. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of financial position, the results of operations, comprehensive loss, changes in stockholders' equity (deficit) and cash flows. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited interim financial statements should be read in conjunction with the audited financial statements and related footnotes for the year ended December 31, 2012, which are included in the Company's prospectus filed pursuant to Rule 424(b) under the Securities and Exchange Act of 1933, as amended, with the Securities and Exchange Commission on May 23, 2013.

Reverse Stock Split

On May 9, 2013, the Company's amended and restated certificate of incorporation was amended to effect a 1-for-16 reverse stock split of its outstanding common stock. The reverse stock split did not cause an adjustment to the par value or the authorized shares of the common stock. As a result of the reverse stock split, the share amounts under the Company's employee incentive plan and common stock warrants were automatically adjusted. The accompanying condensed consolidated financial statements and notes to the condensed consolidated financial statements give retroactive effect to the reverse stock split for all periods presented.

Initial Public Offering

On May 29, 2013, the Company closed the initial public offering ("IPO") of its common stock pursuant to a registration statement on Form S-1 that was declared effective on May 22, 2013. In the IPO, the Company sold an aggregate of 6,612,500 shares of common stock, including the full exercise of the underwriters' option to purchase additional shares, at a public offering price of $14.00 per share. Net proceeds were approximately $82.0 million, after deducting underwriting discounts and commissions of $6.5 million and offering expenses of $4.1 million. Costs directly associated with the IPO were capitalized and recorded as deferred offering costs prior to the closing of the IPO. These costs were recorded as a reduction of the IPO proceeds received in calculating the amount to be recorded in additional paid-in capital.

Upon the closing of the IPO, certain Series C warrants that would otherwise have expired were automatically net exercised into 206,038 shares of redeemable convertible preferred stock. All then-outstanding shares of the Company's redeemable convertible preferred stock were automatically converted into 13,401,499 shares of common stock. The remaining warrants to purchase redeemable convertible preferred stock outstanding as of the closing of the IPO automatically converted into warrants to purchase an aggregate of 216,491 shares of common stock, and the preferred stock warrant liability was reclassified to additional paid-in capital as of May 29, 2013.

In addition, upon the closing of the IPO, the Company's certificate of incorporation was amended and restated to authorize 5,000,000 shares of undesignated preferred stock and 100,000,000 shares of common stock.

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Recent Accounting Pronouncements

The Company has reviewed accounting pronouncements that were issued as of September 30, 2013 and does not believe that these pronouncements will have a material impact on its financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, the useful lives of long-lived assets and other intangible assets, assumptions used for purposes of determining stock-based compensation, income taxes, and the fair value of the Series A and Series C warrants and the Company’s common stock prior to the closing of the IPO, among others. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable, the results of which form the basis for making judgments about the carrying value of assets and liabilities.

Revenue Recognition and Deferred Revenue

The majority of the Company’s revenue is derived from subscription fees paid by customers for access to and usage of the Company’s cloud-based SaaS platform for a specified period of time, which is typically one year. A portion of the subscription fee is typically fixed and is based on a specified minimum amount of gross merchandise value (“GMV”) that a customer expects to process through the Company’s platform over the contract term. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through the Company’s platform in excess of the customer’s specified minimum amount. In addition, other sources of revenue consist primarily of implementation fees, which may include fees for providing launch assistance and training. The Company recognizes revenue when there is persuasive evidence of an arrangement, the service has been provided to the customer, the collection of the fee is reasonably assured and the amount of the fee to be paid by the customer is fixed or determinable. The Company’s contractual arrangements include performance, termination and cancellation provisions, but do not provide for refunds. Customers do not have the contractual right to take possession of the Company’s software at any time.

The Company’s arrangements generally contain multiple elements comprised of subscription and implementation services. The Company evaluates each element in an arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company’s control. The Company’s implementation services are not sold separately from the subscription and there is no alternative use for them. As such, the Company has determined the implementation services do not have standalone value. Accordingly, subscription and implementation services are combined and recognized as a single unit of accounting.

The Company generally recognizes the fixed portion of subscription fees and implementation fees ratably over the contract term. Recognition begins when the customer has access to the Company’s platform and transactions can be processed, provided all other revenue recognition criteria have been met. Some customers elect a managed-service solution and contract with the Company to manage some or all aspects of the Company’s SaaS solutions on the customer’s behalf for a specified period of time, which is typically one year. Under these managed-service arrangements, customer transactions cannot be processed through the Company’s platform until the completion of the implementation services. As such, revenue is contingent upon the Company’s completion of the implementation services and recognition commences when transactions can be processed on the Company’s platform, provided all other revenue recognition criteria have been satisfied. At that time, the Company recognizes a pro-rata portion of the fees earned since the inception of the arrangement. The balance of the fees is recognized ratably over the remaining contract term.

The Company recognizes the variable portion of subscription fee revenue in the period in which the related GMV is processed, provided all other revenue recognition criteria have been met.

The Company recognizes revenue from professional services sold separately from subscription arrangements as the services are performed.

Sales taxes collected from customers and remitted to government authorities are excluded from revenue.

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Deferred revenue represents the unearned portion of fixed subscription fees and implementation fees. Deferred amounts are generally recognized within one year. Those amounts that are expected to be recognized in greater than one year are recorded in other long-term liabilities in the accompanying condensed consolidated balance sheets.

Cost of Revenue

Cost of revenue primarily consists of personnel and related costs, including salaries, bonuses, payroll taxes and stock-based compensation, co-location facility costs for the Company's data centers, depreciation expense for computer equipment directly associated with generating revenue, credit card transaction fees and infrastructure maintenance costs. In addition, the Company allocates a portion of overhead, such as rent, additional depreciation and amortization and employee benefits costs, to cost of revenue based on headcount.

Concentration of Credit Risk

Financial instruments that subject the Company to significant concentrations of credit risk consist primarily of cash and accounts receivable. All of the Company's cash is held at financial institutions that management believes to be of high credit quality. The Company's cash accounts exceed federally insured limits. The Company has not experienced any losses on its cash accounts to date. To manage accounts receivable risk, the Company evaluates the creditworthiness of its customers and maintains an allowance for doubtful accounts.

The Company did not have any customers that individually comprised a significant concentration of its accounts receivable as of September 30, 2013 and December 31, 2012, or a significant concentration of its revenue for the three and nine months ended September 30, 2013 and 2012.

Accounts Receivable and Allowance for Doubtful Accounts

The Company extends credit to customers without requiring collateral. Accounts receivable are stated at realizable value, net of an allowance for doubtful accounts. The Company utilizes the allowance method to provide for doubtful accounts based on management's evaluation of the collectability of amounts due. The Company's estimate is based on historical collection experience and a review of the current status of accounts receivable. Historically, actual write-offs for uncollectible accounts have not significantly differed from the Company's estimates.

Other Receivables

Under certain customer arrangements, the Company collects and remits monthly activity-based fees incurred on specific channels on the customers' behalf. The Company records the amounts due from customers as a result of these arrangements as other receivables.

Other receivables of $0.9 million and $1.5 million are included in prepaid expenses and other current assets on the condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012, respectively.

Deferred Offering Costs

Deferred offering costs of $22,000 and $2.3 million are included in other assets on the condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012, respectively.

Upon the consummation of the IPO on May 29, 2013, the deferred offering costs as of December 31, 2012, in addition to offering costs incurred subsequent to year end but prior to the IPO, were offset against the proceeds of the offering and included in stockholders' equity (deficit).

Upon the consummation of a planned registered public offering in the fourth quarter of 2013, the deferred offering costs as of September 30, 2013 will be offset against the proceeds of the offering and included in stockholders' equity (deficit). If the offering is terminated, the deferred offering costs will be expensed immediately.

Identifiable Intangible Assets

The Company has acquired intangible assets in connection with business combinations. These assets were recorded at their estimated fair values at the acquisition date and are being amortized over their respective estimated useful lives using the straight-line method. The estimated useful lives used in computing amortization are as follows:

Customer relationships	5 to 8 years
Proprietary software	8 years
Trade name	5 years

Goodwill

Goodwill represents the excess of the aggregate of the fair value of consideration transferred in a business combination over the fair value of assets acquired, net of liabilities assumed. Goodwill is not amortized, but is subject to an annual impairment test. The Company tests goodwill for impairment annually on December 31, or more frequently if events or changes in business circumstances indicate the asset might be impaired. For the impairment test, the Company has the option of performing a qualitative assessment to determine whether it is more likely than not that the fair value of its reporting unit is less than its carrying amount. During this assessment, the Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of its reporting unit is less than its carrying amount. Qualitative factors considered include, but are not limited to, macroeconomic conditions, industry and market conditions, company-specific events, changes in circumstances and after-tax cash flows.

If the qualitative factors indicate that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, the Company would then test goodwill for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of the reporting unit to the carrying value of the net assets assigned to the reporting unit. If the fair value of the reporting unit is greater than the carrying value of the net assets assigned to the reporting unit, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit’s carrying value, step two is performed to measure the amount of the impairment, if any. In the second step, the fair value of goodwill is determined by deducting the fair value of the reporting unit’s identifiable assets and liabilities from the fair value of the reporting unit as a whole, as if the reporting unit had just been acquired and the fair value was being initially allocated. If the carrying value of goodwill exceeds the implied fair value, an impairment charge would be recorded in the period the determination is made.

The Company has determined that it has a single, entity-wide reporting unit. To determine the fair value of the Company’s reporting unit, the Company primarily uses a discounted cash flow analysis, which requires significant assumptions and estimates about future operations. Significant judgments inherent in this analysis include the determination of an appropriate discount rate, estimated terminal value and the amount and timing of expected future cash flows. The Company may also determine fair value of its reporting unit using a market approach by applying multiples of earnings of peer companies to its operating results.

Software Development Costs

The Company capitalizes certain internal-use software development costs, consisting primarily of direct labor associated with creating the internally developed software and third-party consulting fees associated with implementing software purchased for internal use. Software development projects generally include three stages: the preliminary project stage (in which all costs are expensed as incurred), the application development stage (in which certain costs are capitalized) and the post-implementation/operation stage (in which all costs are expensed as incurred). The costs incurred during the application development stage primarily include the costs of designing the application, coding and testing of the system. Capitalized costs are amortized using the straight-line method over the estimated useful life of the software once it is ready for its intended use.

Software development costs of $0.2 million and $0.2 million related to creating internally developed software and implementing software purchased for internal use were capitalized during the nine months ended September 30, 2013 and the year ended December 31, 2012, respectively, and are included in property and equipment in the accompanying condensed consolidated balance sheets. Amortization expense related to this capitalized internally developed software was $24,000 and $7,000 for the three months ended September 30, 2013 and 2012, respectively, and $0.1 million and $8,000 for the nine months ended September 30, 2013 and 2012, respectively, and is included in cost of revenue or general and administrative expense in the accompanying condensed consolidated statements of operations, depending upon the nature of the software development project. The net book value of this capitalized internally developed software was $0.3 million and $0.1 million as of September 30, 2013 and December 31, 2012, respectively.

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Software development costs of $1.2 million related to configuring and implementing hosted third-party software applications that the Company will use in its business operations were capitalized during the nine months ended September 30, 2013 and are included in property and equipment in the accompanying condensed consolidated balance sheets. Amortization expense related to these capitalized assets was $8,000 for both the three and nine months ended September 30, 2013 and is included in general and administrative expense in the accompanying condensed consolidated statements of operations. The net book value of these capitalized assets was $1.2 million and $0 as of September 30, 2013 and December 31, 2012, respectively.

Income Taxes

Income taxes are accounted for under the liability method of accounting. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. The measurement of a deferred tax asset is reduced, if necessary, by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The Company applies the accounting guidance for uncertainties in income taxes, which prescribes a recognition threshold and measurement process for recording uncertain tax positions taken, or expected to be taken, in a tax return. Additionally, the guidance also prescribes the treatment for accounting in interim periods, derecognition, classification and disclosure requirements for uncertain tax positions. The Company accrues for the estimated amount of taxes for uncertain tax positions if it is more likely than not that the Company would be required to pay such additional taxes. An uncertain tax position will be recognized if it is not more likely than not to be sustained.

The Company’s income tax provision for the third quarter of 2013 and 2012 reflects its estimates of the effective tax rates expected to be applicable for the full fiscal years, adjusted for any discrete events that are recorded in the period in which they occur. For the three and nine months ended September 30, 2013 and 2012, the Company’s effective tax rate differs from the federal statutory rate primarily due to changes in the valuation allowance and nondeductible expenses.

For the three and nine months ended September 30, 2013 and 2012, the Company had net operating loss (“NOL”) carryforwards, the benefit of which is dependent on the Company’s ability to generate sufficient taxable income prior to the expiration of the NOL carryforwards. In addition, the maximum annual use of the NOL carryforwards is limited in certain situations after changes in stock ownership occur.

Stock-Based Compensation

The Company accounts for stock-based compensation awards based on the fair value of the award as of the grant date. The Company recognizes stock-based compensation expense using the accelerated attribution method, net of estimated forfeitures, in which compensation cost for each vesting tranche in an award is recognized ratably from the service inception date to the vesting date for that tranche.

The Company uses the Black-Scholes option pricing model for estimating the fair value of stock options. The use of the option valuation model requires the input of highly subjective assumptions, including the fair value of the Company’s common stock prior to the IPO, the expected life of the option and the expected stock price volatility based on peer companies. Additionally, the recognition of expense requires the estimation of the number of options that will ultimately vest and the number of options that will ultimately be forfeited.

3. Redeemable Convertible Preferred Stock

The following table summarizes the issuances of redeemable convertible preferred stock prior to the IPO:

Name	Original Issue Price per Share	Number of Shares Outstanding Prior to IPO	Conversion Price per Share
Series A	$0.20	93,966,024	$3.20

Series B	$0.44	40,641,227	$7.04
Series B-1	$0.53	5,660,378	$8.48
Series C	$0.69	74,156,709	$10.96

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Series A, Series B, Series B-1 and Series C redeemable convertible preferred stock are collectively referred to as the "Preferred Stock" and individually as the "Series A," "Series B," "Series B-1" and "Series C", respectively. Each of the prices per share above is referred to as the Original Issue Price, and excludes the cost of issuance.

The following table presents a summary of activity for the Preferred Stock for the nine months ended September 30, 2013 (in thousands):

	Redeemable Convertible Preferred Stock				
	Series A	Series B	Series B-1	Series C	Total
Balance, December 31, 2012	$18,887	$18,000	$3,000	$50,608	$90,495
Cashless exercise of warrants	166	—	—	489	655
Conversion of Preferred Stock into common stock	(19,053)	(18,000)	(3,000)	(51,097)	(91,150)
Balance, September 30, 2013	$—	$—	$—	$—	$—

Upon closing of the Company's IPO on May 29, 2013, all outstanding shares of Preferred Stock converted into an aggregate of 13,401,499 shares of common stock.

4. Warrants

Preferred Stock Warrants

In conjunction with previous long-term debt borrowings, the Company issued warrants to purchase shares of Series A and Series C. As of December 31, 2012, the holders of the Series A warrants and Series C warrants were entitled to purchase a total of 175,000 shares of Series A and 4,586,121 shares of Series C. The warrants could be exercised in whole or in part at any time and included a cashless exercise feature allowing the holder to receive fewer shares of Series A or Series C in exchange for the warrant, rather than paying cash to exercise. The warrants were classified as a liability as of December 31, 2012 in the accompanying condensed consolidated balance sheets.

The fair values of the Series A warrants and Series C warrants were estimated to be $0.1 million and $3.1 million, respectively, at December 31, 2012. The inputs into the fair value model for the warrants, which are discussed in Note 6, "Fair Value Measurements", were considered Level 3 inputs under ASC 820, Fair Value Measurements and Disclosures. Prior to the closing of the IPO, all changes in the fair value of the warrants were recorded in interest expense in the accompanying condensed consolidated statements of operations. The Company recorded interest expense of $0 and $0.1 million for the three months ended September 30, 2013 and 2012, respectively, and interest expense of $1.1 million and $0.1 million for the nine months ended September 30, 2013 and 2012, respectively, related to the fair value adjustment of the warrants.

Certain Series C warrants that would have otherwise expired upon the closing of the IPO were automatically net exercised for an aggregate of 206,038 shares of Series C, which were then automatically converted into 12,874 shares of common stock upon the closing of the IPO. The remaining warrants to purchase redeemable convertible preferred stock converted into warrants to purchase an aggregate of 216,491 shares of common stock, and the related preferred stock warrant liability at its then fair value of $3.6 million was reclassified to additional paid-in capital upon the closing of the IPO.

In May 2013, a holder of Series A and Series C warrants exercised those warrants on a cashless basis and received 144,631 shares of Series A and 70,320 shares of Series C, respectively, in exchange for the warrants. These shares of Series A and Series C converted into an aggregate of 13,433 shares of common stock upon the closing of the IPO.

Common Stock Warrants

In 2007 and 2008, in conjunction with the issuance of the Series C, the Company also issued warrants to purchase 1,616,113 shares of common stock, of which 958,019 and 658,094 have exercise prices per share of $16.00 and $10.96, respectively. The 2007 and 2008 warrants expire in 2014 and 2015, respectively. The warrants may be exercised in whole or in part at any time and include a cashless exercise feature, which allows the holder to receive fewer shares of common stock in exchange for the warrant rather than paying cash to exercise.

In June 2013, the holder of a warrant to purchase common stock executed a cashless exercise and received 194,885 shares of common stock in exchange for the warrant.

In September 2013, the holder of a warrant to purchase common stock executed a cashless exercise and received 6,511 shares of common stock in exchange for the warrant.

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5. Equity Incentive Plans and Stock-Based Compensation

In May 2013, the Company's board of directors adopted, and the Company's stockholders approved, the 2013 Equity Incentive Plan (the "2013 Plan"), pursuant to which the Company initially reserved 1,250,000 shares of its common stock for issuance to its employees, directors and non-employee third parties. The 2013 Plan provides for the grant of incentive stock options to employees, and for the grant of nonqualified stock options, restricted stock awards, restricted stock unit awards, stock appreciation rights, performance stock awards and other forms of stock compensation to the Company's employees, directors, and non-employee third parties. The number of shares of common stock reserved for issuance under the 2013 Plan will automatically increase on January 1 each year, for a period of ten years, from January 1, 2014 through January 1, 2023, by 5% of the total number of shares of the Company's common stock outstanding on December 31 of the preceding calendar year, or a lesser number of shares as may be determined by the Company's board of directors. As a result of the adoption of the 2013 Plan, no further grants may be made under the 2001 Stock Plan described below (the "2001 Plan"). As of September 30, 2013, 1,142,479 shares remained available for future grant.

The 2001 Plan provided for the grant of incentive stock options to employees, and for the grant of nonqualified stock options to employees, directors and non-employee third parties. Stock options were granted at exercise prices not less than the estimated fair market value of the Company's common stock at the date of grant. Stock options generally expire ten years from the date of grant. Certain options are eligible for exercise prior to vesting. Shares issued as a result of early exercise are subject to repurchase by the Company upon termination of employment or services, at the lesser of the price paid or the fair value of the shares on the repurchase date. At September 30, 2013, there were 65,000 shares of common stock outstanding subject to the Company's right of repurchase at a price of $8.64 per share. No such shares were outstanding at December 31, 2012. The Company recorded a liability for the exercise price of unvested shares, which will be reclassified to common stock and additional paid-in capital as the shares vest. At September 30, 2013 and December 31, 2012, the Company recorded $0.6 million and $0, respectively, within other current liabilities in the accompanying condensed consolidated balance sheets for shares issued with repurchase rights.

Stock-based compensation expense related to stock options is included in the following line items in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cost of revenue	$41	$4	$159	$38
Sales and marketing	146	66	439	121
Research and development	89	11	264	74
General and administrative	198	20	571	160
	$474	$101	$1,433	$393

The following table summarizes the assumptions used for estimating the fair value of stock options granted for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Risk-free interest rate	0.3 % - 1.7%	*	0.3% - 1.7%	0.4% - 0.9%
Expected term (years)	6.06 - 6.25	*	5.00 - 6.25	5.00 - 6.25
Expected volatility	49% - 58%	*	49% - 59%	51% - 61%
Dividend yield	0%	*	0%	0%
Weighted average grant date fair value	$10.56	*	$4.73	$3.07

* No options were granted during the three months ended September 30, 2012

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The following is a summary of stock option activity for the nine months ended September 30, 2013:

	Number of Options		Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding options as of December 31, 2012	2,202,712		$ 3.84		
Granted	681,713		11.38		
Exercised	(217,047	)	4.14		
Forfeited	(72,454	)	7.74		
Expired	(25,531	)	2.53		
Outstanding options as of September 30, 2013	2,569,393		$ 5.75	7.46	$79,336
Exercisable as of September 30, 2013	1,333,663		$ 2.98	6.09	$44,876
Vested and expected to vest as of September 30, 2013	2,408,183		$ 5.47	7.35	$75,030

The total compensation cost related to nonvested awards not yet recognized as of September 30, 2013 was $2.5 million and will be recognized over a weighted average period of approximately 1.5 years. The aggregate intrinsic value of stock options exercised during the three months ended September 30, 2013 and 2012 was $0.7 million and $0.3 million, respectively. The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2013 and 2012 was $1.7 million and $0.3 million, respectively.

6. Fair Value Measurements

The carrying amounts of certain of the Company's financial instruments, including cash, accounts receivable, accounts payable and accrued expenses, approximate their respective fair values due to their short-term nature. Prior to the closing of the IPO on May 29, 2013, at which time certain Series C warrants were automatically net exercised and the remaining warrants converted into common stock warrants, the Company's Series A and Series C warrants were recorded at fair value.

The Company uses a three-tier fair value hierarchy to classify and disclose all assets and liabilities measured at fair value on a recurring basis, as well as assets and liabilities measured at fair value on a non-recurring basis, in periods subsequent to their initial measurement. The hierarchy requires the Company to use observable inputs when available, and to minimize the use of unobservable inputs when determining fair value. The three tiers are defined as follows:

- Level 1. Observable inputs based on unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2. Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs for which there is little or no market data, which require the Company to develop its own assumptions.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company evaluates its financial assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level in which to classify them for each reporting period. This determination requires significant judgments to be made. The following table summarizes the conclusions reached as of December 31, 2012 (in thousands):

	Balance as of December 31, 2012	Level 1	Level 2	Level 3
Liabilities:				
Series A warrants(1)	$ 88	$—	$—	$88
Series C warrants(1)	3,147	—	—	3,147
	$ 3,235	$—	$—	$3,235

(1) In order to determine the fair value of the redeemable convertible preferred stock warrants, the Company used a hybrid of the probability-weighted expected return method ("PWERM") and the option pricing model ("OPM"), collectively referred to as the "Hybrid Method," for the year ended December 31, 2012. The Hybrid Method is a

PWERM model in which one of the valuation scenarios is modeled using an OPM.

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Significant inputs for the OPM included an estimate of the fair value of the Series A and C redeemable convertible preferred stock, the remaining contractual life of the warrants, an estimate of the timing of a liquidity event, a risk-free rate of interest and an estimate of the Company's stock volatility using the volatilities of guideline peer companies. Significant inputs for the PWERM included an estimate of the Company's equity value, a weighted average cost of capital and an estimated probability and timing for each valuation scenario.

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs

The following table presents the changes in the Company's Level 3 instruments measured at fair value on a recurring basis during the three months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,			
	2013	2012	2013	2012
	Series A Warrants		Series C Warrants	
Balance as of July 1	$—	$80	$—	$2,489
Change in fair value of warrant liability	—	11	—	58
Balance as of September 30	$—	$91	$—	$2,547

The following table presents the changes in the Company's Level 3 instruments measured at fair value on a recurring basis during the nine months ended September 30, 2013 and 2012 (in thousands):

	Nine Months Ended September 30,			
	2013	2012	2013	2012
	Series A Warrants		Series C Warrants	
Balance as of January 1	$88	$113	$3,147	$479
Change in fair value of warrant liability	78	45	974	23
Issuance of Series C warrant	—	—	—	2,045
Cashless exercise of warrants	(166)	(67)	(489)	—
Reclassification of warrant liability to equity	—	—	(3,632)	—
Balance as of September 30	$—	$91	$—	$2,547

7. Net Loss Per Share

The Company uses the two-class method to compute net loss per share because the Company has issued securities, other than common stock, that contractually entitle the holders to participate in dividends and earnings of the Company. The two-class method requires earnings for the period to be allocated between common stock and participating securities based upon their respective rights to receive distributed and undistributed earnings. Prior to their conversion to common shares, each series of the Company's Preferred Stock was entitled to participate on an as-if-converted basis in distributions, when and if declared by the board of directors, that were made to common stockholders and as a result these shares were considered participating securities. During the third quarter of 2013, certain shares issued as a result of the early exercise of stock options, which are subject to repurchase by the Company, were entitled to receive non-forfeitable dividends during the vesting period and as a result were considered participating securities.

Under the two-class method, for periods with net income, basic net income per common share is computed by dividing the net income attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Net income attributable to common stockholders is computed by subtracting from net income the portion of current year earnings that the participating securities would have been entitled to receive pursuant to their dividend rights had all of the year's earnings been distributed. No such adjustment to earnings is made during periods with a net loss, as the holders of the participating securities have no obligation to fund losses. Diluted net loss per common share is computed under the two-class method by using the weighted average number of shares of common stock outstanding, plus, for periods with net income attributable to common stockholders, the potential dilutive effects of stock options and warrants. In addition, the Company analyzes the potential dilutive effect of the outstanding participating securities under the "if-converted" method when calculating diluted earnings per share, in which it is assumed that the outstanding participating securities convert into common stock at the beginning of the period. The Company reports the more dilutive of the approaches (two class or “if-converted”) as its diluted net income per share during the period. Due to net losses for the three and nine months ended September 30, 2013 and 2012, basic and diluted loss per share were the same, as the effect of potentially dilutive securities would have been anti-dilutive.

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The following securities have been excluded from the calculation of weighted average common shares outstanding because the effect is anti-dilutive for the three and nine months ended September 30, 2013 and 2012:

	Three and Nine Months Ended September 30,	
	2013	2012
Redeemable convertible preferred stock:		
Series A	—	5,863,825
Series B	—	2,540,066
Series B-1	—	353,767
Series C	—	4,617,513
Warrants to purchase common stock	1,625,728	1,616,113
Warrants to purchase Series A redeemable convertible preferred stock	—	10,937
Warrants to purchase Series C redeemable convertible preferred stock	—	239,750
Common stock subject to repurchase	65,000	—
Stock options	2,569,393	1,802,926

8. Segment and Geographic Information

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker (“CODM”) for purposes of allocating resources and evaluating financial performance. The Company’s CODM reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, the Company’s operations constitute a single operating segment and one reportable segment.

Substantially all assets were held in the United States during the three and nine months ended September 30, 2013 and 2012. The following table summarizes revenue by geography for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Domestic	$13,147	$10,362	$37,477	$29,574
International	3,473	2,658	10,041	8,020
Total revenue	$16,620	$13,020	$47,518	$37,594

9. Related Parties

One of the Company’s customers is a subsidiary of a stockholder of the Company, thus making the customer a related party. Under an agreement with this customer, the customer has purchased certain services from the Company. Revenue recorded under this agreement totaled $0.3 million and $0.1 million for the three months ended September 30, 2013 and 2012, respectively, and $0.9 million and $0.6 million for the nine months ended September 30, 2013 and 2012, respectively. Accounts receivable from the customer amounted to $0.4 million and $0.4 million at September 30, 2013 and December 31, 2012, respectively.

One of the Company’s stockholders is also a channel partner with which the Company conducts business. This channel partner, like other channel partners, allows the Company access to its systems and allows the Company to serve as an integration partner between it and the Company’s customers. The Company does not pay or receive consideration from the channel partner for this arrangement.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," or similar expressions, or the negative of such words or phrases, are intended to identify "forward-looking statements." We have based these forward-looking statements on our current expectations and projections about future events. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to these differences include those below and elsewhere in this Quarterly Report on Form 10-Q, particularly in Part II – Item 1A, "Risk Factors," and our other filings with the Securities and Exchange Commission. Statements made herein are as of the date of the filing of this Form 10-Q with the Securities and Exchange Commission and should not be relied upon as of any subsequent date. Unless otherwise required by applicable law, we do not undertake, and we specifically disclaim, any obligation to update any forward-looking statements to reflect occurrences, developments, unanticipated events or circumstances after the date of such statement.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes that appear in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and related notes for the year ended December 31, 2012 appearing in our prospectus filed with the Securities and Exchange Commission on May 23, 2013.

Overview

We are a leading provider of software-as-a-service, or SaaS, solutions that enable our retailer and manufacturer customers to integrate, manage and optimize their merchandise sales across hundreds of online channels. Through our platform, we enable our customers to connect with new and existing sources of demand for their products, including e-commerce marketplaces, such as eBay, Amazon and Newegg, search engines and comparison shopping websites, such as Google, Bing and Nextag, and emerging channels, such as Facebook and Groupon. Our suite of solutions, accessed through a standard web browser, provides our customers with a single, integrated user interface to manage their product listings, inventory availability, pricing optimization, search terms, data analytics and other critical functions across these channels. Our proprietary cloud-based technology platform delivers significant breadth, scalability and flexibility to our customers.

We sell subscriptions to our SaaS solutions primarily through our direct sales force. Our customers include the online businesses of traditional retailers, online retailers and brand manufacturers, as well as advertising agencies that use our solutions on behalf of their retailer clients. As of September 30, 2013, we had over 2,200 core customers worldwide, including 27% of the top 500 U.S. Internet retailers, as identified by Internet Retailer magazine based on their 2012 online sales.

The majority of our revenue is derived from subscription fees paid to us by our customers for access to and usage of our SaaS solutions for a specified contract term, which is usually one year. A portion of the subscription fee is typically fixed and is based on a specified minimum amount of gross merchandise value, or GMV, that a customer expects to process through our platform. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through our platform in excess of the customer's specified minimum GMV amount.

We do not take title to any of the merchandise processed through our platform and we generally do not collect payments on behalf of our customers. We do not hold any inventory of merchandise and we are not involved in the physical logistics of shipping merchandise to buyers, which is handled by our customers.

Key Financial and Operating Performance Metrics

We regularly monitor a number of financial and operating metrics in order to measure our performance and project our future performance. These metrics aid us in developing and refining our growth strategies and making strategic decisions.

Core revenue

Our reported operating results include revenue attributable to the products from two small legacy acquisitions, both of which occurred prior to 2008 and focused on solutions for lower-volume eBay sellers. We do not consider these products to be a core part of our strategic focus going forward. Each of these acquisitions contributed a relatively large number of customers with revenue per customer substantially lower than is characteristic of the rest of our business. We exclude the revenue attributable to these non-core, legacy products in calculating a measure we refer to as core revenue. We anticipate that the revenue associated with these non-core, legacy products will continue to decline over time both in absolute terms and as a percentage of our total revenue.

Number of Core Customers

The number of customers subscribing to our solutions is a primary determinant of our core revenue. We refer to the customers who subscribe to any of our solutions, other than the non-core, legacy products described above, as our core customers. The number of core customers was 2,287 and 1,896 as of September 30, 2013 and 2012, respectively.

Average Revenue per Core Customer

The average revenue generated by our core customers is the other primary determinant of our core revenue. We calculate this metric by dividing our total core revenue for a particular period by the average monthly number of core customers during the period, which is calculated by taking the sum of the number of core customers at the end of each month in the period and dividing by the number of months in the period. We typically calculate average revenue per core customer in absolute dollars on a rolling twelve-month basis, but we may also calculate percentage changes in average revenue per core customer on a quarterly basis in order to help us evaluate our period-over-period performance. Our average revenue per core customer increased 11.6% to $30,113 for the twelve months ended September September 30, 2013 as compared to $26,987 for the twelve months ended September 30, 2012.

Subscription Dollar Retention Rate

We believe that our ability to retain our core customers and expand the revenue they generate for us over time is an important component of our growth strategy and reflects the long-term value of our customer relationships. We measure our performance on this basis using a metric we refer to as our subscription dollar retention rate. We calculate this metric for a particular period by establishing the cohort of core customers that had active contracts as of the end of the prior period. We then calculate our subscription dollar retention rate by taking the amount of fixed subscription revenue we recognized for the cohort in the period for which we are reporting the rate and dividing it by the fixed subscription revenue we recognized for the same cohort in the prior period. For this purpose, we do not include any revenue from the non-core, legacy products described above, any variable subscription fees paid by our customers or any implementation fees.

Although some customers in any given period elect not to renew their contracts with us, our customers that do renew their subscriptions often increase their fixed subscription pricing levels to align with their increasing GMV volumes processed through our platform and may subscribe to additional modules as well. If our subscription dollar retention rate for a period is over 100%, this means that the increased subscription revenue we recognized from customers that renewed their contracts during the period, or whose contracts did not come up for renewal during the period, more than offset the subscription revenue we lost from customers that did not renew their contracts.

For each of the twelve months ended September 30, 2013 and 2012, our subscription dollar retention rate exceeded 100%.

Adjusted EBITDA

Adjusted EBITDA represents our earnings before interest expense, income tax expense and depreciation and amortization, adjusted to eliminate stock-based compensation expense, which is a non-cash item. We believe that excluding these expenses in calculating adjusted EBITDA provides our management with a useful measure for period-to-period comparisons of our business. However, adjusted EBITDA is not a measure calculated in accordance with U.S. GAAP and should not be considered as an alternative to any measure of financial performance calculated and presented in accordance with U.S. GAAP.

Adjusted EBITDA eliminates the impact of stock-based compensation expense, which we do not consider indicative of our operating performance. Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- adjusted EBITDA does not reflect the potentially dilutive impact of equity-based compensation;

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- adjusted EBITDA does not reflect interest or tax payments that may represent a reduction in cash available to us; and
- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

Because of these and other limitations, you should consider adjusted EBITDA together with U.S. GAAP-based financial performance measures, including various cash flow metrics, net income (loss) and our other U.S. GAAP results. The following table presents reconciliation of net loss to adjusted EBITDA for each of the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	$(4,292)	$(1,958)	$(12,019)	$(5,559)
Adjustments:				
Interest expense, net	520	407	2,606	828
Income tax expense	35	43	56	83
Depreciation and amortization expense	886	773	2,619	2,101
Total adjustments	1,441	1,223	5,281	3,012
EBITDA	(2,851)	(735)	(6,738)	(2,547)
Stock-based compensation expense	474	101	1,433	393
Adjusted EBITDA	$(2,377)	$(634)	$(5,305)	$(2,154)

Components of Operating Results

Revenue

We derive the majority of our revenue from subscription fees paid to us by our customers for access to and usage of our SaaS solutions for a specified contract term, which is usually one year. A portion of the subscription fee is typically fixed and based on a specified minimum amount of GMV that a customer expects to process through our platform. The remaining portion of the subscription fee is variable and is based on a specified percentage of GMV processed through our platform in excess of the customer's specified minimum GMV. In most cases, the specified percentage of excess GMV on which the variable portion of the subscription is based is fixed and does not vary depending on the amount of the excess. We also receive implementation fees, which may include fees for providing launch assistance and training.

The following table shows the percentage of our total revenue attributable to fixed subscription fees plus implementation fees, as compared to the percentage attributable to variable subscription fees, for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(as a percentage of total revenue)			
Fixed subscription fees plus implementation fees	70.4 %	65.7 %	67.8 %	62.6 %
Variable subscription fees	29.6	34.3	32.2	37.4
Total revenue	100.0 %	100.0 %	100.0 %	100.0 %

Because our customer contracts contain both fixed and variable pricing components, changes in GMV between periods do not translate directly or linearly into changes in our revenue. We use customized pricing structures for each of our customers depending upon the individual situation of the customer. For example, some customers may commit to a higher specified minimum GMV amount per month in exchange for a lower fixed percentage fee on that committed GMV. In addition, the percentage fee assessed on the variable GMV in excess of the committed minimum for each customer is typically higher than the fee on the fixed, committed portion. As a result, our overall revenue could increase or decrease even without any change in overall GMV between periods, depending on which customers generated the GMV. In addition, changes in GMV from month to month for any individual customer that are below the specified minimum amount would have no effect on our revenue from that customer, and each customer may alternate between being over the committed amount or under it from month to month. For these reasons, while GMV is an important qualitative and directional indicator, we do not regard it as a useful quantitative measurement of our historic revenues or as a predictor of future revenues.

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We recognize fixed subscription fees and implementation fees ratably over the contract period once the contract has been signed by both parties, the customer has access to our platform and transactions can be processed, the fees are fixed or determinable and collection is reasonably assured.

We generally invoice our customers for the fixed portion of the subscription fee in advance, in monthly, quarterly, semi-annual or annual installments. We invoice our customers for the implementation fee at the inception of the arrangement. Fixed subscription and implementation fees that have been invoiced are initially recorded as deferred revenue and are generally recognized ratably over the contract term.

We invoice and recognize revenue from the variable portion of subscription fees in the period in which the related GMV is processed, assuming that the four conditions specified above have been met.

Cost of Revenue

Cost of revenue primarily consists of salaries and personnel-related costs for employees providing services to our customers and supporting our platform infrastructure, including benefits, bonuses and stock-based compensation. Additional expenses include co-location facility costs for our data centers, depreciation expense for computer equipment directly associated with generating revenue, infrastructure maintenance costs, fees we pay to credit card vendors in connection with our customers' payments to us and other direct costs. We plan to continue to expand our capacity to support our growth, which will result in higher cost of revenue in absolute dollars.

Operating Expenses

Sales and marketing expense. Sales and marketing expense consists primarily of salaries and personnel-related costs for our sales and marketing and customer support employees, including benefits, bonuses, stock-based compensation and commissions. We record expense for commissions at the time of contract signing. Additional expenses include marketing, advertising and promotional event programs, corporate communications and travel.

Research and development expense. Research and development expense consists primarily of salaries and personnel-related costs for our research and development employees, including benefits, bonuses and stock-based compensation. Additional expenses include costs related to the development, quality assurance and testing of new technology and enhancement of our existing platform technology, consulting and travel.

General and administrative expense. General and administrative expense consists primarily of salaries and personnel-related costs for administrative, finance and accounting, information systems, legal and human resource employees, including benefits, bonuses and stock-based compensation. Additional expenses include consulting and professional fees, insurance, other corporate expenses and travel, as well as costs associated with compliance with the Sarbanes-Oxley Act and other regulations governing public companies, directors' and officers' liability insurance, increased professional services and an enhanced investor relations function now that we are a public company.

Other Income / Expense

Other income and expense consists primarily of interest income and expense and, prior to the closing of our IPO on May 29, 2013, changes in the fair value of our preferred stock warrant liability. Interest income represents interest received on our cash. Interest expense consists primarily of the interest incurred on outstanding borrowings under our credit facilities and the accretion of the debt discount on our subordinated loan.

Seasonality

Our revenue fluctuates as a result of seasonal variations in our business, principally due to the peak consumer demand and related increased volume of our customers' GMV during the year-end holiday season. As a result, we have historically had higher revenue in our fourth quarter than other quarters in a given year due to increased GMV processed through our platform, resulting in higher variable subscription fees. Along with the seasonally higher revenue we have experienced in the fourth quarter, we have also experienced higher gross margins in the fourth quarter. Our cost to run our platform infrastructure is generally fixed. Therefore, when applied against our generally fixed costs, the higher revenue in the fourth quarter has resulted in higher overall gross margins for us.

Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. We continue to monitor the impact of inflation in order to minimize its effects through pricing strategies, productivity improvements and cost reductions. If our costs were to become subject to significant inflationary pressures, we may not be able

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to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Critical Accounting Policies and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reported period. In accordance with U.S. GAAP, we base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions, and to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected. During the nine months ended September 30, 2013, there were no material changes to our critical accounting policies and use of estimates, which are disclosed in our audited consolidated financial statements for the year ended December 31, 2012 included in our prospectus filed with the Securities and Exchange Commission on May 23, 2013.

Recent Accounting Pronouncements

We have reviewed accounting pronouncements that were issued as of September 30, 2013 and do not believe that these pronouncements will have a material impact on our financial position or results of operations.

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Results of Operations

Comparison of the Three Months Ended September 30, 2013 and 2012

The following table presents our results of operations for the three months ended September 30, 2013 and 2012:

	Three Months Ended September 30,				Period-to-Period Change	
	2013		2012			
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percentage
	(dollars in thousands)					
Revenue	$16,620	100.0 %	$13,020	100.0 %	$3,600	27.6 %
Cost of revenue	4,555	27.4	3,831	29.4	724	18.9
Gross profit	12,065	72.6	9,189	70.6	2,876	31.3
Operating expenses:						
Sales and marketing	9,316	56.1	6,159	47.3	3,157	51.3
Research and development	2,991	18.0	2,459	18.9	532	21.6
General and administrative	3,499	21.1	2,088	16.0	1,411	67.6
Total operating expenses	15,806	95.2	10,706	82.2	5,100	47.6
Loss from operations	(3,741)	(22.6)	(1,517)	(11.6)	(2,224)	146.6
Other (expense) income:						
Interest expense, net	(520)	(3.1)	(407)	(3.1)	(113)	27.8
Other income, net	4	0.0	9	0.1	(5)	(55.6)
Total other (expense) income	(516)	(3.1)	(398)	(3.0)	(118)	29.6
Loss before income taxes	(4,257)	(25.7)	(1,915)	(14.6)	(2,342)	122.3
Income tax expense	35	0.2	43	0.3	(8)	(18.6)
Net loss	$(4,292)	(25.9)%	$(1,958)	(14.9)%	$(2,334)	119.2

Revenue

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
Revenue	$16,620	$13,020	$3,600	27.6 %

Revenue for the three months ended September 30, 2013 increased by $3.6 million, or 27.6%, compared to the three months ended September 30, 2012. The increase in revenue for the three months ended September 30, 2013 was mainly driven by the expansion of our international operations and an increase in our core revenue, which is discussed below.

Our revenue from international operations of $3.5 million, or 20.9% of total revenue, for the three months ended September 30, 2013 increased from $2.7 million, or 20.4% of total revenue, for the three months ended September 30, 2012. The increase in revenue from our international operations was primarily attributable to an increase in the number of international customers.

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Core Revenue

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
Core revenue	$16,219	$12,504	$3,715	29.7 %
Percentage of total revenue	97.6 %	96.0 %		
Non-core revenue	$401	$516	$(115)	(22.3)%
Percentage of total revenue	2.4 %	4.0 %		
Total revenue	$16,620	$13,020	$3,600	27.6 %

Core revenue for the three months ended September 30, 2013 increased by $3.7 million, or 29.7%, compared to the three months ended September 30, 2012.

This growth was primarily attributable to a 20.6% increase in the number of core customers using our platform at September 30, 2013 as compared to September 30, 2012. The increase in core customers accounted for 65.4% of the increase in core revenue during the three months ended September 30, 2013.

In addition, we experienced an 8.6% increase in the average revenue per core customer during the three months ended September 30, 2013 as compared to the three months ended September 30, 2012, which accounted for 34.6% of the increase in core revenue during the period. The increase in the average revenue per core customer was primarily attributable to an overall increase in transaction volume and, to a lesser extent, to modest overall increases in the percentage fees assessed on the fixed and variable portions of GMV under our contractual arrangements with some of our customers during the year. Because we generally enter into annual contracts with our customers, we may renegotiate either or both of the fixed and variable components of the pricing structure of a customer's contract each year. In addition, the increase in average revenue per core customer was due in part to a general shift in our customer base toward a greater proportion of larger enterprise customers, all of which are core customers. Our enterprise customers generally commit to a higher specified minimum amount of GMV per month, which results in a higher proportion of fixed subscription fees.

This growth in core revenue was partially offset by a $0.1 million, or 22.3%, decrease in our non-core revenue over the same period.

Cost of revenue

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
Cost of revenue	$4,555	$3,831	$724	18.9 %
Percentage of total revenue	27.4 %	29.4 %		

Cost of revenue for the three months ended September 30, 2013 increased by $0.7 million, or 18.9%, compared to the three months ended September 30, 2012. The increase in cost of revenue was primarily attributable to a $0.5 million increase in salaries and personnel-related costs, as we increased the number of employees providing services to our expanding customer base and supporting our platform infrastructure from 109 at September 30, 2012 to 129 at September 30, 2013. In addition, we experienced a $0.1 million increase in depreciation expense associated with equipment for our data centers and a $0.1 million increase in credit card vendor transaction fees. As a percentage of revenue, cost of revenue declined from 29.4% for the three months ended September 30, 2012 to 27.4% for the three months ended September 30, 2013.

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Operating Expenses
Sales and marketing

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
Sales and marketing	$9,316	$6,159	$3,157	51.3 %
Percentage of total revenue	56.1 %	47.3 %		

Sales and marketing expense for the three months ended September 30, 2013 increased by $3.2 million, or 51.3%, compared to the three months ended September 30, 2012. The increase in sales and marketing expense was primarily attributable to a $2.3 million increase in salaries and personnel-related costs, as we increased the number of sales and marketing and customer support personnel to continue driving revenue growth. The number of full-time sales and marketing employees increased from 185 at September 30, 2012 to 259 at September 30, 2013. In addition, we experienced a $0.8 million increase in our marketing and advertising expenses, promotional event programs and travel costs. The increase in sales and marketing expense as a percentage of revenue for the three months ended September 30, 2013 reflects our strategy of adding sales and marketing professionals and expanding our marketing activities in order to continue to grow our business.

Research and development

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
Research and development	$2,991	$2,459	$532	21.6 %
Percentage of total revenue	18.0 %	18.9 %		

Research and development expense for the three months ended September 30, 2013 increased by $0.5 million, or 21.6%, compared to the three months ended September 30, 2012. The increase in research and development expense was primarily attributable to a $0.5 million increase in salaries and personnel-related costs associated with an increase in research and development personnel. The number of full-time research and development employees increased from 69 at September 30, 2012 to 80 at September 30, 2013.

General and administrative

	Three Months Ended September 30,		Period-to-Period Change	
	2013	2012	Amount	Percentage
	(dollars in thousands)			
General and administrative	$3,499	$2,088	$1,411	67.6 %
Percentage of total revenue	21.1 %	16.0 %		

General and administrative expense for the three months ended September 30, 2013 increased by $1.4 million, or 67.6%, compared to the three months ended September 30, 2012. The increase in general and administrative expense was primarily attributable to a $0.8 million increase in salaries and personnel-related costs associated with an increase in general and administrative personnel to support our growing business and obligations as a newly public company. The number of full-time general and administrative employees increased from 35 at September 30, 2012 to 48 at September 30, 2013. We also experienced a $0.6 million increase in professional fees related to legal, consulting and audit and tax services.

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Comparison of the Nine Months Ended September 30, 2013 and 2012

The following table presents our results of operations for the nine months ended September 30, 2013 and 2012:

	Nine Months Ended September 30,		
	2013	2012	Period-to-Period Change