

Synacor, Inc.
Form 10-Q
November 17, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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 001-33843

Synacor, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

40 La Riviere Drive, Suite 300

Buffalo, New York
(Address of principal executive offices)

(716) 853-1362

16-1542712
(I.R.S. Employer

Identification No.)

14202
(Zip Code)

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting 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

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 September 30, 2015 there were 29,945,780 shares of the registrant's common stock outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****SYNACOR, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED****AS OF DECEMBER 31, 2014 AND SEPTEMBER 30, 2015**

(In thousands except for share and per share data)

	December 31, 2014	September 30, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 25,600	\$ 15,569
Accounts receivable, net of allowance of \$328 and \$324	20,479	20,810
Prepaid expenses and other current assets	2,292	2,254
Total current assets	48,371	38,633
PROPERTY AND EQUIPMENT, NET	15,128	14,698
OTHER LONG-TERM ASSETS	101	262
GOODWILL	1,565	14,743
INTANGIBLE ASSETS		16,130
INVESTMENTS	1,073	1,016
TOTAL ASSETS	\$ 66,238	\$ 85,482
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 12,545	\$ 11,625
Accrued expenses and other current liabilities	7,761	7,404
Current portion of deferred revenue	642	7,652
Current portion of capital lease obligations	1,150	1,412
Total current liabilities	22,098	28,093
LONG-TERM PORTION OF CAPITAL LEASE OBLIGATION	1,383	1,102
REVOLVING LINE OF CREDIT		4,940
DEFERRED REVENUE		2,952
OTHER LONG-TERM LIABILITIES	275	2,171
TOTAL LIABILITIES	23,756	39,258
Commitments and Contingencies (Note 8)		
STOCKHOLDERS EQUITY:		

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Preferred stock, \$0.01 par value 10,000,000 authorized, none issued and outstanding at December 31, 2014 and September 30, 2015		
Common stock, \$0.01 par value 100,000,000 authorized, 27,944,853 issued and 27,391,709 outstanding at December 31, 2014 and 30,575,470 issued and 29,945,780 outstanding at September 30, 2015	279	311
Treasury stock, at cost, 553,144 at December 31, 2014 and 629,690 at September 30, 2015	(1,142)	(1,232)
Additional paid-in capital	105,961	112,880
Accumulated deficit	(62,636)	(65,722)
Accumulated other comprehensive income (loss)	20	(13)
Total stockholders equity	42,482	46,224
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 66,238	\$ 85,482

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

Table of Contents**SYNACOR, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2015**

(In thousands except for share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
REVENUE	\$ 26,231	\$ 26,351	\$ 75,670	\$ 77,797
COSTS AND OPERATING EXPENSES:				
Cost of revenue (exclusive of depreciation and amortization shown separately below)	14,386	13,298	41,404	40,205
Technology & development (exclusive of depreciation and amortization shown separately below)	7,577	4,361	22,188	13,788
Sales and marketing	2,601	4,274	7,194	11,475
General and administrative (exclusive of depreciation and amortization shown separately below)	4,090	3,712	10,689	10,437
Depreciation and amortization	1,133	1,560	3,308	4,716
Gain on sale of domain			(1,000)	
Total costs and operating expenses	29,787	27,205	83,783	80,621
LOSS FROM OPERATIONS	(3,556)	(854)	(8,113)	(2,824)
OTHER (EXPENSE) INCOME	(14)	(32)		(31)
INTEREST EXPENSE	(75)	(35)	(186)	(144)
LOSS BEFORE INCOME TAXES AND EQUITY INTEREST	(3,645)	(921)	(8,299)	(2,999)
(BENEFIT) PROVISION FOR INCOME TAXES	(1,288)	10	(2,613)	30
LOSS IN EQUITY INTEREST	(239)		(829)	(57)
NET LOSS	\$ (2,596)	\$ (931)	\$ (6,515)	\$ (3,086)
NET LOSS PER SHARE:				
Basic	\$ (0.09)	\$ (0.03)	\$ (0.24)	\$ (0.11)
Diluted	\$ (0.09)	\$ (0.03)	\$ (0.24)	\$ (0.11)

WEIGHTED AVERAGE SHARES USED
TO COMPUTE NET LOSS PER SHARE:

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Basic	27,378,299	27,924,939	27,391,159	27,617,125
Diluted	27,378,299	27,924,939	27,391,159	27,617,125

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

Table of Contents**SYNACOR, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS UNAUDITED****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2015**

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
Net loss	\$ (2,596)	\$ (931)	\$ (6,515)	\$ (3,086)
Other comprehensive (loss) income				
Change in foreign currency translation adjustment	(3)	(27)	6	(33)
Comprehensive loss	\$ (2,599)	\$ (958)	\$ (6,509)	\$ (3,119)

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

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SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2015

(In thousands)

	Nine months ended September 30,	
	2014	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (6,515)	\$ (3,086)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,308	4,716
Stock-based compensation expense	2,754	2,352
Provision for deferred income taxes	(2,636)	
Loss in equity interest	829	57
Gain on sale of domain	(1,000)	
Change in assets and liabilities net of effect of acquisition:		
Accounts receivable, net	(2,338)	3,169
Prepaid expenses and other current assets	(84)	584
Other long-term assets	221	59
Accounts payable	(2,099)	(1,003)
Accrued expenses and other current liabilities	1,714	(205)
Deferred revenue	163	(706)
Other long-term liabilities	(611)	241
Net cash (used in) provided by operating activities	(6,294)	6,178
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3,945)	(2,474)
Investment in equity interest	(605)	
Acquisition net of cash acquired		(17,260)
Proceeds from sale of domain	1,000	
Net cash used in investing activities	(3,550)	(19,734)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on capital lease obligations	(1,700)	(975)
Proceeds from bank financing		4,940
Proceeds from exercise of common stock options	62	70
Purchase of treasury stock	(562)	
Deferred acquisition payment		(495)
Net cash (used in) provided by financing activities	(2,200)	3,539

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Effect of exchange rate changes on cash and cash equivalents	6	(14)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(12,038)	(10,031)
CASH AND CASH EQUIVALENTS - Beginning of Period	36,397	25,600
CASH AND CASH EQUIVALENTS - End of Period	\$ 24,359	\$ 15,569
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	\$ 186	\$ 144
Cash paid for income taxes	\$ 112	\$ 154
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Property, equipment and service contracts financed under capital lease obligations	\$ 1,489	\$ 637
Contingent consideration	\$	\$ 1,600
Fair value of common stock and warrants in acquisition	\$	\$ 4,395
Accrued property and equipment expenditures	\$ 39	\$ 82
Stock-based compensation capitalized to property and equipment	\$ 37	\$ 134
Treasury stock received to satisfy minimum tax withholding liabilities	\$ 9	\$ 77

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

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SYNACOR, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED

AS OF DECEMBER 31, 2014 AND SEPTEMBER 30, 2015, AND

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014 AND 2015

1. The Company and Summary of Significant Accounting Policies

Synacor, Inc., together with its consolidated subsidiaries (collectively, the Company or Synacor), is the trusted technology development, multiplatform services and revenue partner for video, Internet and communications providers, device manufacturers, and enterprises. Synacor delivers modern, multiscreen experiences and advertising to their consumers that require scale, actionable data and sophisticated implementation.

Basis of Presentation The interim unaudited condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) and include the accounts of the Company and its wholly-owned subsidiaries. Investments in entities in which the Company can exercise significant influence, but does not own a majority equity interest or otherwise have the power to control, are accounted for using the equity method and are included as investments in equity interest on the condensed consolidated balance sheets. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company's management, the interim unaudited condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company's financial position for the periods presented. These interim unaudited condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period and should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014 (as amended).

Accounting Estimates The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

Concentrations of Risk As of December 31, 2014 and September 30, 2015, and for the three and nine months ended September 30, 2014 and 2015, the Company had concentrations equal to or exceeding 10% of the Company's accounts receivable and revenue as follows:

	Accounts Receivable	
	December 31, 2014	September 30, 2015
Google	23%	12%
Portal Customer	11%	12%
Digital Advertising Partner (1)	12%	N/A

(1) As of September 30, 2015, accounts receivable for Digital Advertising Partner was less than 10%.

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	Revenue			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2015	2014	2015

Google	39%	28%	45%	31%
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For the three and nine months ended September 30, 2014 and 2015, the following customers received revenue-share payments equal to or exceeding 10% of the Company's cost of revenue. The costs represent revenue share paid to customers for their supply of Internet traffic on the Company's start experiences:

	Cost of Revenue			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2015	2014	2015

Customer A	22%	29%	23%	28%
Customer B	14%	10%	13%	10%
Customer C (1)	N/A	10%	10%	10%
Customer D (2)	16%	N/A	12%	N/A

Notes:

- (1) For the three months ended September 30, 2014, the cost of revenue-share payments received by Customer C was less than 10%
- (2) For the three and nine months ended September 30, 2015 the cost of revenue-share payments received by Customer D was less than 10%

Rights Plan On July 14, 2014 the board of directors declared a dividend of one preferred share purchase right (a Right) for each outstanding share of the Company's common stock and adopted a stockholder rights plan (the Rights Plan). The Rights were issued July 14, 2014 to the stockholders of record at the close of business on that date. Each Right allows its holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock (a Series A Junior Preferred Share) for \$10.00 per share (the Exercise Price), if the Rights become exercisable. This portion of a Series A Junior Preferred Share will give the stockholder approximately the same dividend, voting, and liquidation rights as would one share of common stock. Prior to exercise, the Right does not give its holder any dividend, voting, or liquidation rights. On July 14, 2014, in conjunction with the adoption of the Rights Plan, the Company designated 2,000,000 shares of its Preferred Stock as Series A Junior Participating Preferred Stock.

The Rights will not be exercisable until 10 days after the public announcement that a person or group has become an Acquiring Person by obtaining beneficial ownership of 10% or more of the Company's outstanding common stock (the Distribution Date) unless the Rights Plan is amended by the board of directors to avoid such outcome. If a person or group becomes an Acquiring Person, each Right will entitle its holder (other than such Acquiring Person) to purchase for \$10.00 per share, a number of shares of the Company's common stock having a market value of twice such price based on the market price of the common stock prior to such acquisition. Additionally, if the Company is acquired in a merger or similar transaction after the Distribution Date, each Right will entitle its holder (other than such Acquiring Person) to purchase for \$10.00 per share, a number of shares of the acquiring corporation with a market value of \$20.00 per share based on the market price of the acquiring corporation's stock, prior to such merger. In addition, at any time after a person or group becomes an Acquiring Person, but before such Acquiring Person or group owns 50% or more of the Company's common stock, the board of directors may exchange one share of the Company's common stock for each outstanding Right (other than Rights owned by such Acquiring Person, which would have

become void). An Acquiring Person will not be entitled to exercise the Rights.

On April 20, 2015, The Company's stockholders ratified the Rights Plan. It will expire on July 14, 2017.

On August 18, 2015, the Company amended the definition of "Acquiring Person" to provide that (i) issuances of securities under plans, contracts or arrangements approved by the board of directors or its compensation committee as compensation for service as a director, employee or consultant of Synacor or any of its subsidiaries will not trigger the exercisability of the Rights and (ii) issuances of securities in consideration for the acquisition of assets or a business in a transaction approved by the board of directors will not trigger the exercisability of the Rights.

Acquisition In September 2015, the Company acquired certain assets from Zimbra, Inc., now known as TZ Holdings, Inc. ("TZ Holdings"), principally comprised of its email collaboration products and services business (the "Purchased Business"). The Company expects the Purchased Business to enhance its business development efforts. In consideration for the Purchased Business, the Company issued to TZ Holdings 2.4 million shares of its common stock and warrants to purchase 480,000 shares of its common stock. The exercise price of the warrants is \$3.00 per share with a three year life. Additionally, the Company paid TZ Holdings \$17.3 million in cash consideration and assumed certain obligations of TZ Holdings, including the performance of TZ Holdings' post-closing obligations under contracts assigned to Synacor. Under the terms of the acquisition, TZ Holdings is eligible to receive certain contingent consideration. The purchase price was allocated to the assets acquired based on their respective fair values as of the acquisition date, with the amount exceeding the fair value recorded as goodwill of \$13.2 million.

Table of Contents**2. Acquisition**

On August 18, 2015 the Company and Sync Holdings, LLC, its wholly-owned subsidiary, entered into an Asset Purchase Agreement (the "Asset Purchase Agreement") with Zimbra, Inc. (now known as TZ Holdings) to acquire certain assets related to its email collaboration products and services business, including certain of its wholly-owned foreign subsidiaries. The business acquired by the Company pursuant to the Asset Purchase Agreement is referred to herein as "Zimbra" or the Purchased Business. Zimbra connects hundreds of millions of people and information with unified collaboration software that includes email, calendaring, file sharing, activity streams, social networks and more. Zimbra's software is used globally by service providers, governments and companies. The Company completed the acquisition (the "Acquisition") on September 14, 2015 (the "Closing").

Purchase Price The total purchase price paid (including the fair value of the contingent consideration described below) for the Purchased Business was approximately \$23.3 million. At the Closing, in consideration for the Purchased Business, the Company paid TZ Holdings \$17.3 million in cash and issued to TZ Holdings 2.4 million shares of its common stock (such shares, the "Closing Stock Consideration"), valued at \$3.5 million, and warrants to purchase 480,000 shares of common stock (the "Closing Warrants"). Additionally, TZ Holdings is eligible to receive additional contingent consideration as described below.

Contingent Consideration TZ Holdings is eligible to receive up to an additional \$2.0 million (the "Earn Out Consideration") in cash upon the satisfaction of certain business performance milestones related to Zimbra after the Closing, subject to and contingent upon any reduction to satisfy indemnification claims (including pending claims), as further described in the Asset Purchase Agreement. The fair value of this contingent consideration was determined to be \$1.6 million and is included in consideration paid.

In addition to the Earn Out Consideration, the Company has held back an additional 0.6 million shares of common stock (the "Holdback Stock" and together with the Closing Stock Consideration, the "Stock Consideration") and warrants to purchase an additional 120,000 shares of common stock (the "Holdback Warrants" and together with the Closing Warrants, the "Warrants") to secure TZ Holdings' indemnification obligations under the Asset Purchase Agreement. Any Holdback Shares and Holdback Warrants not used to satisfy indemnification claims (including pending claims) will be released to TZ Holdings eighteen months following the Closing. The Company accrued contingent consideration relating to the Holdback Stock and the Holdback Warrants based on its estimated fair value at the Closing.

Additionally, the Company has assumed certain obligations of TZ Holdings, including the performance of TZ Holdings' post-closing obligations under contracts assigned to the Company.

Consideration:

Cash consideration	\$ 17,310
Fair value of 2,400,000 shares of common stock issued at \$1.45 per share on September 14, 2015	3,480
Fair value of Closing and Holdback Warrants (warrants to purchase an aggregate of 600,000 shares of common stock)	45
Fair value of the Holdback Stock (i.e additional 600,000 shares of common stock) on September 14, 2015	870
Fair value of contingent consideration	1,600

Total purchase price

\$ 23,305

In connection with the Acquisition, TZ Holdings has agreed not to sell, transfer or otherwise dispose of any portion of the Stock Consideration until the first anniversary of the Closing. Upon the first anniversary of the Closing, the restrictions will lapse with respect to 1/6th of the Stock Consideration, and upon the completion of each of the five months thereafter, the restrictions will lapse with respect to an additional 1/6th of the Stock Consideration. Following the lapse of such restrictions, TZ Holdings may transfer the Stock Consideration solely to its stockholders.

Allocation of Purchase Price The purchase price was determined in accordance with the accounting treatment of a business combination in accordance with the Business Combination Topic of the Financial Accounting Standards Board Accounting Standard Codification 805. Under the guidance, the fair value of the consideration was determined and the assets acquired and liabilities assumed have been recorded at their fair values at the date of acquisition. The excess of the purchase price over the estimated fair values has been recorded as goodwill.

The allocation of purchase price to the assets acquired and liabilities assumed as the date of the acquisition is presented in the table below. Management is responsible for determining the fair value of the tangible and identifiable intangible assets acquired and liabilities assumed as of the Acquisition Date. Management considered a number of factors, including reference to an analysis under Financial Accounting Standards Board Accounting Standard Codification 805 solely for the

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purpose of allocating the purchase price to the assets acquired and liabilities assumed. The Company's estimates are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. These valuations require the use of management's assumptions, which would not reflect unanticipated events and circumstances that occur.

Assets acquired	
Cash and cash equivalents	\$ 50
Accounts receivable, net	3,500
Prepaid expenses and other current assets	547
Property and equipment, net	1,194
Other long-term assets	219
Goodwill	13,178
Intangible assets	16,200
Total assets acquired	34,888
Liabilities assumed	
Accounts payable	134
Accrued expenses and other current liabilities	409
Current portion of deferred revenue	7,468
Current portion of capital lease obligations	246
Long-term portion of capital lease obligations	71
Deferred revenue	3,200
Other long-term liabilities	55
Total liabilities assumed	11,583
Net assets acquired	\$ 23,305

While the Company uses its best estimates and assumptions as part of the purchase price allocation process to value the assets acquired and liabilities assumed, the purchase price allocation is preliminary and could change during the measurement period (not to exceed one year) if new information is obtained about the facts and circumstances that existed as of the date of Closing that, if known, would have resulted in the recognition of additional or changes in the value of the assets and liabilities presented in the purchase price allocation.

During the third quarter of fiscal year 2015, acquisition costs of \$0.5 million were recorded as incurred as administrative expenses in the Condensed Consolidated Statement of Operations.

Technology Zimbra has an open-source integrated collaboration software suite with secure email, calendaring and related services. The Zimbra software is used by over 100 million paid users in on-premises, public and private cloud deployments. The valuation of these assets was based on the discounted cash flows estimated using the relief from royalty method, a form of the income approach. The royalty rate was 2% for technology. The fair value of technology at date of acquisition was \$1.1 million and has an amortization period of 6 years.

Trademark Synacor acquired several issued and pending patents as well as the Zimbra trademark. The valuation of these assets was based on the discounted cash flows estimated using the relief from royalty method, a form of the income approach. The royalty rate was 0.5% for trademark. The fair value of the trademark at date of acquisition was

\$0.3 million and has an amortization period of 6 years.

Customer Relationships Through Zimbra, Synacor has acquired a diverse set of customer relationships. The majority of Zimbra revenue is related to geographies outside of North America. The largest customer segment is Internet Service Providers (ISPs), while smaller but still important verticals include small-to-medium businesses and the government/non-profit sector. Zimbra makes direct sales to ISPs as well as indirect sales through an extensive global channel of reseller and service-provider partners. The fair value of customer lists was determined using the multi-period excess-earnings method, a form of the income approach. The fair value of customer relationships at date of acquisition was \$14.8 million and has an amortization period of 15 years.

Deferred Revenue The deferred revenue obligation assumed by Synacor is associated with maintenance and support, licenses and professional services. Synacor accounted for the acquired deferred revenue at its acquisition date fair value, which was determined utilizing the cost approach. The cost approach was based upon management's assessment of the cost to be incurred in connection with the continuing legal obligation associated with the acquired contracts plus a reasonable profit margin. The fair value of deferred revenue at date of acquisition was \$10.7 million.

Goodwill The excess of the purchase price over the fair value of net tangible and intangible assets acquired and liabilities assumed was allocated to goodwill. Various factors contributed to the establishment of goodwill, including: the value of Zimbra's trained workforce; the incremental value that Zimbra's technology will bring to the Company; and the expected revenue growth over time that is attributable to increased market penetration from future products and customers. The goodwill acquired in connection with the acquisition is deductible for tax purposes.

Pro Forma Results Set forth below is the pro forma consolidated results of operations of the Company and Zimbra as if the acquisition occurred as of the beginning of fiscal year 2014 (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
Revenue	\$ 34,086	\$ 32,434	\$ 96,117	\$ 97,066
Operating (loss) income	(4,460)	8	(11,318)	(3,911)
Net loss	(3,266)	(276)	(9,486)	(3,698)
Loss per share				
Basic	\$ (0.11)	\$ (0.01)	\$ (0.32)	\$ (0.12)
Diluted	\$ (0.11)	\$ (0.01)	\$ (0.32)	\$ (0.12)

Since the closing of the Acquisition, through September 30, 2015, the Purchased Business generated revenue of approximately \$0.9 million.

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3. Investments and Fair Value Measurements

In July 2013, the Company made a \$1.0 million investment (in the form of a convertible promissory note) in a privately held Delaware corporation called Blazer and Flip Flops, Inc., or B&FF (doing business as The Experience Engine). In March 2015, the note was converted into preferred stock of B&FF. B&FF is a professional services company whose principals have experience integrating its customers' systems with their consumers' devices, including smartphones and tablets.

In September 2015, the Company purchased certain assets from Zimbra, Inc. (now known as TZ Holdings). TZ Holdings is eligible to receive up to an additional \$2.0 million (the Earn Out Consideration) in cash upon the satisfaction of certain business performance milestones related to Zimbra after the Closing, subject to and contingent upon any reduction to satisfy indemnification claims (including pending claims), as further described in the Asset Purchase Agreement. The fair value of this contingent consideration was determined to be \$1.6 million.

The provisions of the Financial Accounting Standards Board Accounting Standard Codification 820, *Fair Value Measurements and Disclosures*, establish a framework for measuring the fair value in accordance with U.S. GAAP and establish a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value as follows:

Level 1 Level 1 inputs are defined as observable inputs such as quoted prices in active markets.

Level 2 Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 Level 3 inputs are unobservable inputs that reflect the Company's determination of assumptions that market participants would use in pricing the asset or liability. These inputs are developed based on the best information available, including the Company's own data.

The Company classifies the Earn Out Consideration within Level 3 because it is valued using unobservable inputs.

Table of Contents**4. Goodwill**

The change in goodwill is as follows (in thousands) for the nine months ended September 30, 2015:

At December 31, 2014	\$ 1,565
Zimbra acquisition related goodwill	\$ 13,178
At September 30, 2015	\$ 14,743

There was no change in goodwill for the nine months ended September 30, 2014.

5. Property and Equipment Net

Property and equipment, net consisted of the following:

	December 31, 2014	September 30, 2015
	(in thousands)	
Computer equipment (1)	\$ 21,194	\$ 22,749
Computer software	10,741	12,508
Furniture and fixtures	1,847	1,910
Leasehold improvements	1,389	1,392
Work in process (primarily software development costs)	1,203	1,553
Other	173	177
	36,547	40,289
Less accumulated depreciation (2)	(21,419)	(25,591)
Total property and equipment net	\$ 15,128	\$ 14,698

Depreciation expense for the three months ended September 30, 2014 and 2015 was \$1.1 million and 1.5 million, respectively. Depreciation expense for the nine months ended September 30, 2014 and 2015 was \$3.3 million and 4.6 million, respectively.

Notes:

- (1) Includes equipment under capital lease obligations of \$4.8 million and \$3.6 million as of December 31, 2014 and September 30, 2015, respectively.
- (2) Includes \$2.7 million and \$1.4 million of accumulated depreciation of equipment under capital leases as of December 31, 2014 and September 30, 2015, respectively.

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following:

	December 31, 2014	September 30, 2015
	(in thousands)	
Accrued compensation	\$ 4,066	\$ 4,424
Accrued content fees	1,745	1,910
Accrued business acquisition consideration	495	
Other	1,455	1,070
Total	\$ 7,761	\$ 7,404

Table of Contents**7. Information About Segment and Geographic Areas**

Operating segments are components of the Company in which separate financial information is available that is evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and in assessing performance. The chief operating decision maker for the Company is the Chief Executive Officer. The Chief Executive Officer reviews financial information presented on a total Company basis, accompanied by information about revenue by major service line for purposes of allocating resources and evaluating financial performance. Profitability measures by service line are not routinely prepared or used. The Company has one business activity and there are no segment managers who are held accountable for operations, operating results or plans for levels or components below the Company level. Accordingly, the Company has determined that it has a single reporting segment and operating unit structure.

The following table sets forth revenue and long-lived tangible assets by geographic area:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
	(in thousands)			
Revenue				
United States	\$ 26,070	\$ 25,556	\$ 75,174	\$ 76,623
International	161	795	496	1,174
Total revenue	\$ 26,231	\$ 26,351	\$ 75,670	\$ 77,797

	December 31,	September 30,
	2014	2015
	(in thousands)	
Long-lived tangible assets		
United States	\$ 14,573	\$ 13,626
Canada	502	676
Asia		396
Europe	53	
Total long-lived tangible assets	\$ 15,128	\$ 14,698

8. Commitments and Contingencies

Contract Commitments The Company is obligated to make payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of September 30, 2015 are summarized as follows:

Year ending December 31:

(in thousands)

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2015 (remaining three months)	\$	1,290
2016		4,140
2017		2,020
2018		660
Total contract commitments	\$	8,110

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Litigation From time to time, the Company is a party to legal actions. In the opinion of management, the outcome of these matters is not expected to have a material impact on the consolidated financial statements of the Company.

9. Equity

Common Stock Effective on February 15, 2012, the Company's board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of common shares that the Company is authorized to issue is 100,000,000 with a par value of \$0.01 per share.

Preferred Stock Effective on February 15, 2012, the Company's board of directors and stockholders approved the Fifth Amended and Restated Certificate of Incorporation. The total number of preferred shares that the Company is authorized to issue is 10,000,000 with a par value of \$0.01 per share, 2,000,000 of which have been designated as Series A Junior Participating Preferred Stock pursuant to the Rights Plan and the Certificate of Designation approved by the Company's board of directors effective July 17, 2014. None have been issued to date.

Stock Repurchases In February 2014 the board of directors approved a Stock Repurchase Program, which authorizes a repurchase of up to \$5.0 million worth of the Company's outstanding common stock. The Stock Repurchase Program has no expiration date, and may be suspended or discontinued at any time without notice. The Company repurchased all shares with cash reserves.

The following table sets forth the shares of common stock repurchased through the program:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2015	2014	2015
Shares of common stock repurchased			229,050	
Value of common stock repurchased (in thousands)	\$	\$	\$ 562	\$

Withhold to Cover During the nine months ended September 30, 2015, certain employees, in lieu of paying withholding taxes on the vesting of certain shares of restricted stock awards, authorized the withholding of 76,546 shares of the Company's common stock to satisfy their minimum statutory tax withholding requirements related to such vesting. These shares were recorded as treasury stock using the cost method at the per share closing price on the date of vesting. The number of shares of the Company's common stock withheld to cover minimum statutory tax withholding requirements during the nine months ended September 30, 2014 was 3,603.

Table of Contents**10. Stock-based Compensation**

The fair value of each stock option was determined on the date of grant using the Black-Scholes option pricing model, and stock-based compensation is recorded over the requisite service period. No income tax deduction is allowed for incentive stock options (ISOs). Accordingly, no deferred income tax asset is recorded for the potential tax deduction related to these options. Expense related to stock option grants of non-qualified stock options (NSOs) result in a temporary difference, which gives rise to a deferred tax asset.

Total stock-based compensation expense included in the accompanying condensed consolidated statements of operations for the periods presented, is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2015	2014	2015
	(in thousands)			
Technology and development	\$ 691	\$ 224	\$ 1,392	\$ 694
Sales and marketing	129	231	361	716
General and administrative	406	355	1,001	942
Total stock-based compensation expense	\$ 1,226	\$ 810	\$ 2,754	\$ 2,352

Stock Option Activity A summary of the stock option activity for the nine months ended September 30, 2015 is presented below:

	Number of Stock Options	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted Average Remaining Contractual Term (in years)
Outstanding January 1, 2015	6,754,082	\$ 2.83		
Granted	1,632,500	\$ 2.11		
Exercised	(36,135)	\$ 1.94		
Forfeited	(647,091)	\$ 2.43		
Outstanding September 30, 2015	7,703,356	\$ 2.72	\$ 109	7.21
Vested and expected to vest September 30, 2015	7,306,187	\$ 2.74	\$ 109	7.11
Vested and exercisable September 30, 2015	3,807,171	\$ 3.10	\$ 109	5.47

Aggregate intrinsic value represents the difference between the Company's closing stock price of its common stock and the exercise price of outstanding, in-the-money options. The Company's closing stock price as reported on the

NASDAQ as of September 30, 2015 was \$1.35 per share. The total intrinsic value of options exercised for the nine months ended September 30, 2015 was minor. The weighted average fair value of options issued during the nine months ended September 30, 2015 amounted to \$1.14 per option share.

As of September 30, 2015, the unrecognized compensation cost related to non-vested options granted, for which vesting is probable, under the plan was approximately \$5.1 million. This cost is expected to be recognized over a weighted-average period of 2.6 years. The total fair value of shares vested was \$1.5 million for the nine months ended September 30, 2015.

Table of Contents**11. Net Income (Loss) Per Common Share Data**

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, and to a lesser extent, shares issuable upon the release of RSUs. The dilutive effect of these potential common shares is reflected in diluted earnings per share by application of the treasury stock method.

The following table presents the calculation of basic and diluted net loss per share for the three and nine months ended September 30, 2014 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
	(in thousands, except share and per share data)			
Basic net loss per share:				
Numerator:				
Net loss	\$ (2,596)	\$ (931)	\$ (6,515)	\$ (3,086)
Denominator:				
Weighted-average common shares outstanding	27,378,299	27,924,939	27,391,159	27,617,125
Basic net loss per share	\$ (0.09)	\$ (0.03)	\$ (0.24)	\$ (0.11)
Diluted net loss per share:				
Numerator:				
Net loss	\$ (2,596)	\$ (931)	\$ (6,515)	\$ (3,086)
Denominator:				
Number of shares used in basic calculation	27,378,299	27,924,939	27,391,159	27,617,125
Add weighted-average effect of dilutive securities:				
None				
Number of shares used in diluted calculation	27,378,299	27,924,939	27,391,159	27,617,125
Diluted net loss per share	\$ (0.09)	\$ (0.03)	\$ (0.24)	\$ (0.11)

The following equivalent shares were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015

(in thousands)

Antidilutive equity awards:				
Stock options and RSUs	8,436,928	8,223,520	8,436,928	8,223,520
Warrants		480,000		480,000