

Synacor, Inc.
Form 10-Q
August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number 001-33843

Synacor, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

16-1542712
(I.R.S. Employer Identification No.)

40 La Riviere Drive, Suite 300 14202

Edgar Filing: Synacor, Inc. - Form 10-Q

Buffalo, New York
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (716) 853-1362

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

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

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

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

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

As of August 3, 2018, there were 38,965,241 shares of the registrant's common stock outstanding.

SYNACOR, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
PART I. <u>FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets – Unaudited as of June 30, 2018 and December 31, 2017</u>	1
<u>Condensed Consolidated Statements of Operations – Unaudited for the Three and Six Months Ended June 30, 2018 and 2017</u>	2
<u>Condensed Consolidated Statements of Comprehensive Loss – Unaudited for the Three and Six Months Ended June 30, 2018 and 2017</u>	3
<u>Condensed Consolidated Statements of Cash Flows—Unaudited for the Six Months Ended June 30, 2018 and 2017</u>	4
<u>Notes to the Condensed Consolidated Financial Statements – Unaudited as of June 30, 2018 and December 31, 2017, and for the Three and Six Months Ended June 30, 2018 and 2017</u>	5
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	14
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	24
Item 4. <u>Controls and Procedures</u>	25
PART II. <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	26
Item 1A. <u>Risk Factors</u>	26
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
Item 3. <u>Defaults Upon Senior Securities</u>	44
Item 4. <u>Mine Safety Disclosures</u>	45
Item 5. <u>Other Information</u>	45
Item 6. <u>Exhibits</u>	45
<u>SIGNATURES</u>	47

Edgar Filing: Synacor, Inc. - Form 10-Q

Treasury stock – at cost, 848,754 shares at June 30, 2018 and 842,220		
shares at December 31, 2017	(1,893)	(1,881)
Additional paid-in capital	143,720	142,486
Accumulated deficit	(89,152)	(86,627)
Accumulated other comprehensive loss	(204)	(29)
Total stockholders' equity	52,864	54,345
Total liabilities and stockholders' equity	\$91,004	\$ 108,780

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

SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(In thousands except for share and per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
REVENUE	\$35,923	\$31,216	\$68,838	\$57,756
COSTS AND OPERATING EXPENSES:				
Cost of revenue (exclusive of depreciation and amortization shown separately below)	18,256	14,462	33,473	27,024
Technology and development (exclusive of depreciation and amortization shown separately below)	6,069	6,904	12,756	14,202
Sales and marketing	6,904	6,185	12,840	12,846
General and administrative (exclusive of depreciation and amortization shown separately below)	4,320	4,361	9,337	8,325
Depreciation and amortization	2,444	2,224	4,879	4,408
Total costs and operating expenses	37,993	34,136	73,285	66,805
LOSS FROM OPERATIONS	(2,070)	(2,920)	(4,447)	(9,049)
OTHER (EXPENSE) INCOME	(133)	67	(14)	73
INTEREST EXPENSE	(88)	(114)	(185)	(201)
LOSS BEFORE INCOME TAXES	(2,291)	(2,967)	(4,646)	(9,177)
INCOME TAX PROVISION	293	309	313	755
NET LOSS	\$(2,584)	\$(3,276)	\$(4,959)	\$(9,932)
NET LOSS PER SHARE:				
Basic	\$(0.07)	\$(0.09)	\$(0.13)	\$(0.29)
Diluted	\$(0.07)	\$(0.09)	\$(0.13)	\$(0.29)
WEIGHTED AVERAGE SHARES USED TO COMPUTE NET				
LOSS PER SHARE:				
Basic	38,823,056	37,284,973	38,808,690	34,228,367
Diluted	38,823,056	37,284,973	38,808,690	34,228,367

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

SYNACOR, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS –
 UNAUDITED
 FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018 AND 2017
 (In thousands)

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net loss	\$(2,584)	\$(3,276)	\$(4,959)	\$(9,932)
Other comprehensive income:				
Changes in foreign currency translation adjustment	(111)	(1)	(175)	44
Comprehensive loss	\$(2,695)	\$(3,277)	\$(5,134)	\$(9,888)

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

SYNACOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017

(In thousands)

	Six Months Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(4,959)	\$(9,932)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,879	4,408
Capitalized software impairment	—	256
Stock-based compensation expense	1,090	1,323
Provision for deferred income taxes	(119)	219
Increase in estimated value of contingent consideration	—	107
Changes in operating assets and liabilities:		
Accounts receivable, net	9,942	9,611
Prepaid expenses and other assets	(882)	(136)
Accounts payable	(9,479)	(3,132)
Accrued expenses and other liabilities	(1,107)	(3,436)
Deferred revenue	(1,946)	(764)
Net cash used in operating activities	(2,581)	(1,476)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(3,978)	(3,576)
Net cash used in investing activities	(3,978)	(3,576)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from offering of common stock, net of underwriting costs	—	20,258
Payments of public offering issuance costs	—	(212)
Repayments of long-term debt	—	(5,000)
Repayments on capital lease obligations	(867)	(701)
Proceeds from exercise of common stock options	103	786
Treasury stock received to satisfy minimum withholding liabilities	(12)	(117)
Deferred acquisition payments	—	(1,300)
Net cash (used in) provided by financing activities	(776)	13,714
Effect of exchange rate changes on cash and cash equivalents	(187)	6
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(7,522)	8,668
Cash and cash equivalents, beginning of period	22,476	14,315
Cash and cash equivalents, end of period	\$14,954	\$22,983
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	\$175	\$109
Cash paid for income taxes	\$185	\$394
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Property, equipment and service center contracts financed under capital lease	\$—	\$3,488
Minimum capital lease payments in accounts payable	\$436	\$—
Accrued property and equipment expenditures	\$208	\$550

Stock-based compensation capitalized to property and equipment	\$36	\$86
--	------	------

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

4

SYNACOR, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

AS OF JUNE 30, 2018 AND DECEMBER 31, 2017, AND

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018 AND 2017

1. The Company and Summary of Significant Accounting Principles

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, governments and enterprises. Synacor enables its customers to provide their consumers engaging, 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. 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.

The accompanying condensed consolidated balance sheet as of December 31, 2017 was derived from the audited financial statements as of that date, but does not include all the information and footnotes required by U.S. GAAP. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

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 June 30, 2018 and December 31, 2017, the Company had concentrations equal to or exceeding 10% of the Company’s accounts receivable as follows:

Edgar Filing: Synacor, Inc. - Form 10-Q

	Accounts Receivable	
	June 30, 2018	December 31, 2017
Google advertising affiliate *	16	%
Google search *	7	%
Advertising customer *	12	%

* - Less than 10%

For the three months and six months ended June 30, 2018 and 2017, the Company had concentrations equal to or exceeding 10% of the Company's revenue as follows:

	Revenue			
	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Google search	14%	16 %	14%	14 %
Google advertising affiliate	12%	21 %	14%	17 %

* - Less than 10%

For the three months and six months ended June 30, 2018 and 2017, the following customers received revenue-share payments equal to or exceeding 10% of the Company's cost of revenue:

	Cost of Revenue			
	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2018	2017	2018	2017
Customer A	*	13 %	*	16 %
Customer B	30 %	18 %	26 %	10 %
* - Less than 10%				

Recent Accounting Pronouncements —

Not Yet Adopted

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842) which amends lease accounting by lessors and lessees. This new standard will require, among other things, that lessees recognize a right-to-use asset and related lease liability for all significant financing and operating leases, and specifies where in the statement of cash flows the related lease payments are to be presented. The standard is effective for years beginning after December 15, 2018, including interim periods within those years (beginning in calendar year 2019 for the Company), and early adoption is permitted. The Company is currently in the process of evaluating the impact the adoption of ASU 2016-02 will have on its consolidated financial statements, but currently expects that all of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon the adoption of ASU 2016-02, which will increase the total assets and total liabilities that it reports as compared to those reported prior to adoption. The Company will adopt the standard on the required effective date, which for the Company will be January 1, 2019.

Recently Adopted

On January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers ("Topic 606"), using the modified retrospective method. Results for reporting periods beginning on or after January 1, 2018 are presented under Topic 606; however, prior period amounts are not adjusted and continue to be reported in accordance with the accounting standards in effect for those periods. The Company recorded a reduction to the opening balance of the accumulated deficit of \$2.5 million as of January 1, 2018 due to the cumulative impact of the adoption of Topic 606. The impact to revenue recorded for the quarter ended June 30, 2018 was an increase of approximately \$0.3 million with the adoption of Topic 606 as compared to Topic 605. The impact to revenue for the six months ended June 30, 2018 was an increase of approximately \$0.1 million with the adoption of Topic 606 as compared to Topic 605.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. This ASU reduces the diversity in reporting of eight specific cash flow issues due to accounting guidance that is unclear or does not exist. The eight issues relate to certain debt activities, business combination activities, insurance

settlements and other various activities. The Company adopted this ASU as of January 1, 2018 and it did not have an impact on our consolidated financial statements.

2. Revenue from Contracts with Customers

The following is a description of principal activities from which the Company generates revenue. Revenue is recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that is expected to be received in exchange for those goods or services. The Company generates all of our revenue from contracts with customers.

Search & Digital Advertising

The Company uses internet advertising to generate revenue from the traffic on our Managed Portals and Advertising solutions, categorized as search advertising and digital advertising. For search advertising, the Company has a revenue-sharing relationship with Google, pursuant to which the Company includes a Google-branded search tool on our Managed Portals. When a Google consumer makes a search query using this tool, the Company delivers the query to Google and they return search results to consumers that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us. The net payment received from Google is recognized as revenue. Digital advertising includes video, image and text advertisements delivered on our Managed Portals. Advertising inventory is filled with advertisements sourced by our direct sales force and advertising network partners. Revenue is generated when an advertisement displays, otherwise known as an impression, or when consumers view or click an advertisement, otherwise known as an action. Digital advertising revenue is on a cost per impression or cost per action basis. Digital advertising also includes advertising fees received for the placement of syndicated digital advertisements with other digital advertising publishers, for which the Company acquires and pay for the space (inventory) on a cost per impression or cost per action basis. Revenue is recognized based on amounts received from advertising customers as the impressions are delivered or the actions occur, according to contractually-determined rates.

Recurring and Fee-Based

Recurring and Fee-Based revenue includes subscription fees and other fees that are received from customers for the use of our proprietary technology, including the use of, or access to, email, Cloud ID, security services, games and other premium services and paid content. Monthly subscriber levels typically form the basis for generating Recurring and Fee-Based revenue. This revenue is typically determined by multiplying a per-subscriber per-month fee by the number of subscribers using the particular services being offered or consumed, except in the case of software licenses and support, which are based on a fixed fee. Revenue earned as subscription fees and maintenance and support fees is recognized from customers as our obligation to deliver the service is satisfied, which is when the service is delivered. Revenue is also recognized from the licensing and distribution of our Email/Collaboration products and services, including licenses of intellectual property. Software license revenue is recognized up front upon delivery of the licensed product and the utility that enables the customer to access authorization keys, provided that a signed contract has been received. The Company typically sells term-based software licenses that expire, which are referred to as subscription licenses, but also sell perpetual licenses for our Email products. The software is delivered before related services are provided and is functional without professional services, updates, and technical support.

Many of the Company's contracts with customers contain multiple performance obligations. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are typically estimated using the residual approach. Standalone selling prices of services are typically estimated based on observable transactions when these services are sold on a standalone basis. The Company usually expects payment within 30 to 90 days from the invoice date (fulfillment of performance obligations or per contract terms). None of our contracts as of June 30, 2018 contained a significant financing component. Differences

between the amount of revenue recognized and the amount invoiced, collected from, or paid to our customers are recognized as deferred revenue.

7

Disaggregation of revenue

The following table provides information about disaggregated revenue for the three and six months ended June 30, 2018 by primary geographical market and timing of revenue recognition, and includes a reconciliation of the disaggregated revenue with reportable types (in thousands):

	Three Months Ended June 30, 2018		Timing of Revenue Recognition		
	Geographic Area		Products transferred		
	United States (in thousands)	International	at a point in time (in thousands)	Products and services transferred over time	Total
Revenue:					
Search and Digital advertising	\$ 20,461	\$ 517	\$20,978	\$ —	\$20,978
Recurring and Fee-based	8,893	6,052	3,935	11,010	\$14,945
Total revenue	\$ 29,354	\$ 6,569	\$24,913	\$ 11,010	\$35,923
	Six Months Ended June 30, 2018		Timing of Revenue Recognition		
	Geographic Area		Products transferred		
	United States (in thousands)	International	at a point in time (in thousands)	Products and services transferred over time	Total
Revenue:					
Search and Digital advertising	\$ 39,128	\$ 1,678	\$40,806	\$ —	\$40,806
Recurring and Fee-based	17,264	10,768	6,149	21,883	\$28,032
Total revenue	\$ 56,392	\$ 12,446	\$46,955	\$ 21,883	\$68,838

Remaining Performance Obligations

Deferred revenue is recorded when cash payments are received or due in advance of revenue recognition from software licenses, professional services, and maintenance agreements. The timing of revenue recognition may differ from the timing of billings to customers. The changes in deferred revenue, inclusive of both current and long-term, are as follows:

(in thousands)

Edgar Filing: Synacor, Inc. - Form 10-Q

Beginning balance - January 1, 2018	\$ 15,287
Record the cumulative effect of ASC 606 implementation	(2,456)
Recognition of deferred revenue	(7,200)
Deferral of revenue	5,254
Ending Balance - June 30, 2018	\$ 10,885

The majority of the deferred revenue balance above relates to the maintenance and support contracts for Email software licenses. These are recognized straight-line over the life of the contract, with the majority of the balance being recognized within the next twelve months.

Practical Expedients

The Company generally expenses sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which revenue is recognized at the amount to which the Company has the right to invoice for services performed.

3. Acquisitions

In August 2015, the Company and Zimbra, Inc. (now known as “TZ Holdings”) entered into an agreement under which the Company acquired certain assets relating to TZ Holdings’ email/collaboration products and services business, including certain of its wholly-owned foreign subsidiaries, for cash consideration of \$17.3 million, 2.4 million shares of common stock and warrants to purchase 480,000 shares of common stock (collectively valued at \$3.2 million). The Company held back an additional 600,000 shares of common stock and warrants to purchase an additional 120,000 shares of common stock (collectively valued at \$0.8 million at the acquisition date) to secure TZ Holdings’ indemnification obligations including pending claims. The held back common shares and warrants were released to TZ holdings in March 2017. The warrants expire on September 14, 2018.

Additionally, TZ Holdings was eligible to receive cash consideration of up to \$2.0 million (the “Earn-Out Consideration”) upon the satisfaction of certain business performance milestones following the closing of the transaction, subject to and contingent upon any reduction to satisfy indemnification claims including pending claims. The acquisition date fair value of this contingent consideration was estimated to be \$1.6 million. The Company paid \$0.9 million of the Earn-Out Consideration to TZ Holdings in November 2016, and the Company paid the remaining \$0.7 million of the Earn-Out Consideration in May 2017.

In connection with the Company’s February 2016 acquisition of Technorati, the Company withheld \$0.5 million of the purchase price to secure Technorati’s indemnification obligations under the Asset Purchase Agreement, and the Company owed approximately \$0.1 million in post-closing working capital adjustments. These amounts were paid in March 2017.

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Customer and publisher relationships	\$ 14,780	\$ 14,780
Technology	2,330	2,330
Trademark	300	300
	17,410	17,410
Less accumulated amortization	(5,786)	(4,715)
Intangible assets, net	\$ 11,624	\$ 12,695

Amortization of intangible assets totaled \$0.5 million and \$0.5 million for the three months ended June 30, 2018 and 2017, respectively, and \$1.1 million and \$1.1 million for the six months ended June 30, 2018 and 2017 respectively.

5. Property and Equipment – Net

Property and equipment, net consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Computer equipment	\$ 28,970	\$ 28,845
Computer software	26,280	23,690

Edgar Filing: Synacor, Inc. - Form 10-Q

Furniture and fixtures	1,623	1,497
Leasehold improvements	1,246	1,215
Work in process (primarily software development costs)	4,500	3,758
Other	181	159
	62,800	59,164
Less accumulated depreciation	(42,400)	(38,659)
Property and equipment, net	\$20,400	\$ 20,505

Depreciation expense totaled \$1.9 million and \$1.7 million for the three months ended June 30, 2018 and 2017, respectively, and \$3.8 million and \$3.3 million, for the six months ended June 30, 2018 and 2017, respectively.

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Accrued compensation	\$3,673	\$ 4,361
Accrued content fees and other costs of revenue	795	655
Accrued taxes	230	426
Other	1,231	1,633
Total	\$5,929	\$ 7,075

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. 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 tables set forth revenue and long-lived tangible assets by geographic area (in thousands):

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
Revenue:				
United States	\$25,190	\$29,354	\$46,858	\$56,392
International	6,026	6,569	10,898	12,446
Total revenue	\$31,216	\$35,923	\$57,756	\$68,838

	June 30, 2018	December 31, 2017
Long-lived tangible assets:		
United States	\$19,790	\$ 19,775
International	610	730
Total long-lived tangible assets	\$20,400	\$ 20,505

8. Commitments and Contingencies

Contract Commitments —

The Company is obligated to make minimum payments under various contracts with vendors and other business partners, principally for revenue-share and content arrangements. Contract commitments as of June 30, 2018 are as follows (in thousands):

Year ending December 31,	
2018 (remaining six months)	\$450
2019	1,353
2020	753
Total	\$2,556

Capital Lease Commitments —

Capital lease commitments for the remainder of 2018 and for the following two years as of June 30, 2018 are summarized as follows (in thousands):

	Capital Lease
Years Ending December 31,	Commitments
2018 (remaining six months)	\$ 1,727
2019	2,348
2020	1,152
Total minimum capital lease commitments	5,227
Less-amount representing interest	(239)
Total capital lease obligations	4,988
Less-minimum capital lease obligations in accounts payable	(436)
Less-current portion of capital lease obligations	(2,364)
Long-term portion of capital lease obligations	\$ 2,188

Litigation —

From time to time, the Company is a party to legal actions. In consultation with counsel, as it relates to any current pending matters, the outcome of these matters is not expected to have a material impact on the consolidated financial statements of the Company.

The Company and two of its executive officers were recently named as defendants in a putative securities class action lawsuit filed April 4, 2018 in the United States District Court for the Southern District of New York. The complaint makes various allegations regarding statements related to the contractual arrangement between the Company and AT&T Inc. (“AT&T”), and the effect of that arrangement on the Company’s revenue. The complaint seeks unspecified damages, interest and other costs. The court appointed a lead plaintiff and approved plaintiff’s selection of lead counsel on July 6, 2018. On August 2, 2018, plaintiffs filed an amended complaint asserting the same claims arising from similar allegations as the first complaint. The Company’s pre-motion letter regarding its anticipated motion to dismiss the amended complaint is due on August 17, 2018. The Company and its officers dispute these claims and will defend vigorously against any allegations of wrongdoing.

9. Stock-based Compensation

The Company has stock-based employee compensation plans for which compensation cost is recognized in its financial statements. The cost is measured at the grant date, based on the fair value of the award, determined using the Black-Scholes option pricing model, and is recognized as an expense over the employee’s requisite service period (generally the vesting period of the equity award).

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”) results in a temporary difference, which gives rise to a deferred tax asset.

The following table presents the weighted-average assumptions used to estimate the fair value of options granted during the periods indicated:

Edgar Filing: Synacor, Inc. - Form 10-Q

	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017		
Weighted average grant date fair value	\$0.98	\$ 1.55		
Expected dividend yield	-	%	-	%
Expected stock price volatility	48	%	47	%
Risk-free interest rate	2.7	%	2.1	%
Expected life of options (in years)	6.25		6.39	

11

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Technology and development	\$134	\$206	\$268	\$414
Sales and marketing	126	190	264	358
General and administrative	277	280	558	551
Total stock-based compensation expense	\$537	\$676	\$1,090	\$1,323

Stock Option Activity – A summary of the stock option activity for the six months ended June 30, 2018 is presented below:

	Number of Shares	Weighted Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2018	8,478,213	\$ 2.60		
Granted	894,100	1.96		
Exercised	(59,241)	1.65		
Forfeited or expired	(571,711)	2.32		
Outstanding at June 30, 2018	8,741,361	\$ 2.56	6.60	\$ 591
Vested and expected to vest at June 30, 2018	8,493,707	\$ 2.56	6.52	\$ 576
Vested and exercisable at June 30, 2018	5,951,234	\$ 2.60	5.64	\$ 371

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 Global Market as of June 30, 2018 was \$2.00 per share. The total intrinsic value of options exercised for the six months ended June 30, 2018 was minimal. The weighted average fair value of options granted during the six months ended June 30, 2018 amounted to \$0.98 per option share.

As of June 30, 2018, the unrecognized compensation cost related to options granted, for which vesting is probable, and adjusted for estimated forfeitures, was approximately \$3.2 million. This cost is expected to be recognized over a weighted-average remaining period of 2.6 years.

10. Net Loss Per Common Share Data

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net 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, warrants, 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.

Stock options, warrants and RSUs are not included in the calculation of diluted net loss per share for the three and six months ended June 30, 2018 and 2017 because the Company had a net loss for each of those periods. The inclusion of these equity awards would have had an antidilutive effect on the calculation of diluted loss per share. As such, the Company's calculations of basic and diluted net loss per share are identical.

12

Edgar Filing: Synacor, Inc. - Form 10-Q

The following table presents the calculation of basic and diluted net loss per share for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic net loss per share:				
Numerator:				
Net loss (in thousands)	\$ (2,584)	\$ (3,276)	\$ (4,959)	\$ (9,932)
Denominator:				
Weighted average common shares outstanding	38,823,056	37,284,973	38,808,690	34,228,367
Basic net loss per share	\$ (0.07)	\$ (0.09)	\$ (0.13)	\$ (0.29)
Diluted net loss per share:				
Numerator:				
Net loss (in thousands)	\$ (2,584)	\$ (3,276)	\$ (4,959)	\$ (9,932)
Denominator:				
Weighted average common shares outstanding - basic	38,823,056	37,284,973	38,808,690	34,228,367
Add - potentially dilutive securities (options, RSUs and warrants)	—	—	—	—
Weighted average common shares outstanding - diluted	38,823,056	37,284,973	38,808,690	34,228,367
Diluted net loss per share	\$ (0.07)	\$ (0.09)	\$ (0.13)	\$ (0.29)

The following securities 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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Anti-dilutive equity awards:				
Stock options	8,741,361	9,475,205	8,741,361	9,475,205
Restricted stock units	34,607	189,443	34,607	189,443
Warrants	600,000	600,000	600,000	600,000

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. In addition, we may make other written and oral communications from time to time that contain such statements. Forward-looking statements include statements as to industry trends and future expectations of ours and other matters that do not relate strictly to historical facts. These statements are often identified by the use of words such as "may," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and other expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. These forward-looking statements include statements in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations." Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" included elsewhere in this Form 10-Q and in our other Securities and Exchange Commission filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes thereto appearing elsewhere in this Form 10-Q and with the consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Our Business

We enable our customers to better engage with their consumers. Our customers include video, internet and communications providers, device manufacturers, governments and enterprises. We are their trusted technology development, multiplatform services and revenue partner. Our customers use our technology platforms and services to scale their businesses and extend their subscriber relationships. We deliver managed portals, advertising solutions, email and collaboration platforms, and cloud-based identity management.

We enable our customers to provide their consumers engaging, multiscreen experiences with products that require scale, actionable data and sophisticated implementation. Through our Managed Portals and Advertising solutions, we enable our customers to earn incremental revenue by monetizing media among their consumers. At the same time, because consumers have high expectations for their online experience as a result of advances in video, mobile and social, we provide, through our Recurring and Fee-Based revenue solutions, a suite of products and services that helps our customers successfully meet those high expectations by enabling them to deliver to their consumers access to the same digital content across all devices, including PCs, tablets, smartphones and connected TVs.

Overview

We generate search and digital advertising revenue from consumer traffic on our Managed Portals and Advertising solutions, which we collect from our search partner, Google Inc., or Google, our advertising network providers and directly from advertisers. We typically share a portion of this Managed Portals and Advertising revenue with our customers. Growth in this portion of our business is dependent on expansion of relationships with our existing customers and new customers adopting our Managed Portals and Advertising solutions and increased engagement by their consumers with these solutions.

We also generate revenue from our Recurring and Fee-Based revenue solutions for the use of our technology, email and messaging, premium services and paid content. We generate this revenue in the form of licensing fees including perpetual licenses, subscription licenses, maintenance and support fees and professional services. As we expand our Cloud ID, syndicated content, Email/Collaboration and other premium services offerings, we expect to generate increased Recurring and Fee-Based revenue from our customers.

During the three months ended June 30, 2018, Managed Portals and Advertising revenue was \$21.0 million, an increase of 17% as compared to \$18.0 million for the three months ended June 30, 2017. During the six months ended June 30, 2018, Managed Portals and Advertising revenue was \$40.8 million, an increase of 29% as compared to \$31.5 million for the six months ended June 30, 2017.

Search revenue decreased by \$0.1 million, or 3%, for the three months ended June 30, 2018 compared to the same period in 2017, due to the effects of ongoing migration of search activity at other portal customers from personal computers to other devices, such as tablets and smartphones, and the residual effect of the placement of our Managed Portals and Advertising solutions on the second tab of

the default Windows 8 and Windows 10 internet browsers, partially offset by search revenue attributable to the AT&T Portal (including personal computers, smartphones and tablets), which was fully deployed by the end of the second quarter in 2017. Search revenue increased by \$2.0 million, or 26%, for the six months ended June 30, 2018 as compared to the same period in 2017, primarily due to revenue attributable to the AT&T Portal (including personal computers, smartphones and tablets), which was not fully deployed until the end of the second quarter in 2017.

Digital advertising revenue increased by \$3.1 million, or 24%, during the three months ended June 30, 2018 as compared to the same period in 2017, and by \$7.2 million, or 31%, during the six months ended June 30, 2018 as compared to the same period in 2017. These increases in digital advertising revenue were driven by advertising on the AT&T Portal and higher syndicated advertising revenue, partially offset by effects of ongoing migration of other portal customers from personal computers to other devices, such as tablets and smartphones.

We expect that both search and digital advertising activity and revenue will increase in future quarters due to our three-year portal services contract with AT&T Services, Inc., or AT&T, to provide Managed Portals and Advertising solutions (including the AT&T Portal) for use by AT&T's consumers. We entered into the portal services contract with AT&T in May 2016, we completed deployment of the AT&T Portal in June 2017, and we expect to see increasing search and digital advertising revenue as monetization of the AT&T Portal is optimized. In addition, we expect a future increase of search activity on smartphones and tablets as we believe our continuing investment in our next-generation Managed Portals and Advertising solutions will allow us to compete more effectively for search activity on smartphones and tablets.

Our Recurring and Fee-Based revenue consists of fees charged for the use of our proprietary technology and for the use of, or access to, services, such as e-mail and messaging, security, Cloud ID, online games, music and other premium services and paid content. For the three months ended June 30, 2018, Recurring and Fee-Based revenue was \$14.9 million, an increase of \$1.7 million compared to the same period in 2017. For the six months ended June 30, 2018, Recurring and Fee-Based revenue was \$28.0 million, an increase of \$1.8 million, or 7%, compared to the same period in 2017. This increase was primarily attributable to increased portal licensing revenue, hosted email revenue and increased professional services revenue, offset by decreased premium services and the effects of the transition of e-mail customers from perpetual to subscription license revenue.

As we obtain new customers and those new customers introduce our Managed Portals and Advertising solutions to their consumers, and as new customers migrate their consumers from their existing technology to our technology over a period of time, we expect usage of our solutions and revenue from those Managed Portals and Advertising solutions to increase. Moreover, a new customer may initially launch a selection of our services and products, rather than our entire suite of offerings and subsequently broaden their service and product offerings over time. When a customer launches a new service or product, marketing and promotional activities may be required to generate awareness and interest among consumers.

Revenue attributable to our customers includes the Recurring and Fee-Based revenue earned directly from them, as well as the Managed Portals and Advertising revenue generated through our relationships with our search and digital advertising partners (such as Google for search advertising and advertising networks, advertising agencies and advertisers for digital advertising). This revenue is attributable to our customers because it is produced from the traffic on our Managed Portals. These search and advertising partners provide us with advertisements that we then deliver with search results and other content on our Managed Portals. Since our search advertising partner, Google, and our advertising network partners generate their revenue by selling those advertisements, we create a revenue stream for these partners. In the three and six months ended June 30, 2018, search revenue through our relationship with Google generated \$4.9 million and \$9.9 million, or approximately 14% of our revenue for both periods. For the three and six months ended June 30, 2018, Managed Portals and Advertising solutions and other services attributable to one customer accounted for \$10.5 million and \$19.0 million, or approximately 29% and 28% of our revenue, respectively.

The initiatives described below under “Key Initiatives” are expected to contribute to our ability to maintain and grow revenue and return to operating profitability via increases in advertising revenue, increases in customers and our consumer reach, and increases in availability of products across more devices. We expect the period in which we experience a return on future investments in each of these initiatives to differ. For example, more direct advertising at higher rates would be expected to have an immediate and direct impact on profitability while expansion into international markets may require an investment that involves a longer term return.

Key Initiatives

Our strategy is supported by four key pillars to drive our business, with operational discipline and sound financial footing as its base. We plan to:

- increase value for existing customers by optimizing consumer experience and monetization;
- innovate on Synacor-as-a-platform for advanced services;

15

- win new customers in current and related verticals; and
- extend our product portfolio into emerging growth areas.

Key Business Metric

In addition to the line items in our financial statements, we review the number of Multiplatform Unique Visitors to evaluate our business, determine the allocation of resources and make decisions regarding business strategies. We believe disclosing this metric is useful for investors and analysts to understand the underlying trends in our business. The following table reflects the average number of multiplatform unique visitors for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Multiplatform Unique Visitors	201,132,198	198,346,614	201,686,161	199,582,427

We define Multiplatform Unique Visitors as consumers who have visited one of our Managed Portals from either mobile or desktop sources at least once, computed on an average monthly basis during a particular time period, plus the number of consumers who have viewed an advertisement through our advertising network, computed on an average monthly basis during a particular time period. As the number of Multiplatform Unique Visitors increases, we expect that we will generate additional revenue from our Managed Portals and Advertising solutions. We rely on comScore to provide this data. comScore estimates this data based on the U.S. portion of the internet activity of its worldwide panel of consumers and its proprietary data collection method.

Components of our Results of Operations

Cost of Revenue

Cost of revenue consists primarily of revenue sharing, content acquisition costs, co-location facility costs, royalty costs, and product support costs. Revenue sharing consists of amounts accrued and paid to customers for the internet traffic on Managed Portals we operate on our customers' behalf and where we are the primary obligor, resulting in the generation of search and digital advertising revenue. The revenue-sharing agreements with customers are primarily variable payments based on a percentage of the search and digital advertising revenue. Content-acquisition agreements may be based on a fixed payment schedule, on the number of subscribers per month, or a combination of both. Fixed-payment agreements are expensed on a straight-line basis over the term defined in the agreement. Agreements based on the number of subscribers are expensed on a monthly basis. Co-location facility costs consist of rent and operating costs for our data center facilities. Royalty costs consist of amounts due to other parties for license of email software with third party technology enabled. Product support costs consist of employee and operating costs directly related to our maintenance and professional services support.

Technology and Development

Technology and development expenses consist primarily of compensation-related expenses incurred for the research and development of, enhancements to, and maintenance and operation of our products, equipment and related infrastructure. Technology and development expenses also include certain costs of operating data centers domestically and internationally.

Sales and Marketing

Sales and marketing expenses consist primarily of compensation-related expenses to our direct sales and marketing personnel, as well as costs related to advertising, industry conferences, promotional materials and other sales and marketing programs. Advertising cost is expensed as incurred.

General and Administrative

General and administrative expenses consist primarily of compensation-related expenses for executive management, finance, accounting, human resources, professional fees and other administrative functions.

Depreciation and Amortization

Depreciation and amortization includes depreciation and amortization of our computer hardware and software, including our capitalized internally-developed software, furniture and fixtures, intangible assets, leasehold improvements and other property, as well as depreciation on capital leased assets.

Other (Expense) Income

Other income consists primarily of foreign currency transaction gains and losses, and interest income earned.

Interest Expense

Interest expense consists of interest on capital leases and outstanding bank borrowings, if any.

Provision for Income Taxes

Income tax provision consists of federal and state income taxes in the United States and taxes in certain foreign jurisdictions, as well as any changes to deferred tax assets or liabilities, and deferred tax valuation allowances. Our income tax provision also includes amounts withheld for payment of income taxes upon payment of our invoices by our customers in certain foreign jurisdictions. Those amounts increase the amount of our foreign tax credit which would defray our U.S. tax liability if we were presently a U.S. taxpayer. However, because the deferred income tax assets relating to our federal tax attributes, including our foreign tax credits, are fully reserved, any such foreign tax withholdings are charged to our income tax provision. Such amounts paid may be carried forward to offset future federal income tax liabilities for a period of ten years. Finally, we record a deferred income tax provision to reflect the recognition of deferred tax liabilities relating to goodwill and certain intangible assets that cannot be predicted to reverse for book purposes during our loss carry-forward periods.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon 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, judgments and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

For a discussion of our critical accounting policies and estimates, see “Critical Accounting Policies and Estimates” included in our Annual Report on Form 10-K for the year ended December 31, 2017 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We have updated our revenue recognition policies in conjunction with the adoption of ASC 606 as further described in Note 2 to the accompanying condensed consolidated financial statements. No other significant changes have occurred to our critical accounting policies and estimates.

Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed within this Quarterly Report on Form 10-Q adjusted EBITDA, a non-U.S. GAAP financial measure. We define adjusted EBITDA

as net income (loss) plus: provision (benefit) for income taxes, interest expense, other (income) expense, depreciation and amortization, asset impairments, stock-based compensation, restructuring costs, acquisition costs and certain other one-time items. We have provided a reconciliation below of adjusted EBITDA to net income (loss), the most directly comparable U.S. GAAP financial measure.

We have included adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short- and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Additionally, adjusted EBITDA is a key financial measure used by the compensation committee of our board of directors in connection with the payment of bonuses to our executive officers. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

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 and asset impairments are non-cash charges, the assets being depreciated, amortized or impaired may have to be replaced in the future, and adjusted EBITDA does not reflect 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 consider the potentially dilutive impact of equity-based compensation;
- adjusted EBITDA does not reflect the impact of tax payments that may represent a reduction in cash available to us;
- adjusted EBITDA does not reflect the impact of principal or interest payments required to service our capital leases or long-term debt borrowings (if any);
- adjusted EBITDA does not reflect the impact of the cost of business acquisitions on the cash available to us;
- adjusted EBITDA does not reflect the impact of non-recurring items, such as the costs associated with reductions in workforce, on the 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 limitations, you should consider adjusted EBITDA alongside other financial performance measures, including various cash flow metrics, net loss and our other U.S. GAAP results. The following table presents a reconciliation of adjusted EBITDA to net loss for each of the periods indicated:

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
	(in thousands)		(in thousands)	
Reconciliation of Adjusted EBITDA:				
Net loss	\$ (2,584)	\$ (3,276)	\$ (4,959)	\$ (9,932)
Income tax provision	293	309	313	755
Interest expense	88	114	185	201
Other expense (income)	133	(67)	14	(73)
Depreciation and amortization	2,444	2,224	4,879	4,408
Capitalized software impairment	—	256	—	256
Stock-based compensation expense	537	676	1,090	1,323
Restructuring costs	268	—	268	—
Adjusted EBITDA	\$ 1,179	\$ 236	\$ 1,790	\$ (3,062)

Results of Operations

The following tables set forth our results of operations for the periods presented in amount and as a percentage of revenue for those periods. The period to period comparison of financial results is not necessarily indicative of future results.

	Three Months		Six Months Ended	
	Ended		June 30,	
	June 30,	2017	2018	2017
	(in thousands)		(in thousands)	
Revenue	\$35,923	\$31,216	\$68,838	\$57,756
Costs and operating expenses:				
Cost of revenue ¹	18,256	14,462	33,473	27,024
Technology and development ^{1 2}	6,069	6,904	12,756	14,202
Sales and marketing ²	6,904	6,185	12,840	12,846
General and administrative ^{1 2}	4,320	4,361	9,337	8,325
Depreciation and amortization	2,444	2,224	4,879	4,408
Total costs and operating expenses	37,993	34,136	73,285	66,805
Loss from operations	(2,070)	(2,920)	(4,447)	(9,049)
Other (expense) income	(133)	67	(14)	73
Interest expense	(88)	(114)	(185)	(201)
Loss before income taxes	(2,291)	(2,967)	(4,646)	(9,177)
Income tax provision	293	309	313	755
Net loss	\$(2,584)	\$(3,276)	\$(4,959)	\$(9,932)

Notes:

¹Exclusive of depreciation and amortization shown separately

² Includes stock-based compensation, as follows:

	Three		Six Months	
	Months		Ended	
	Ended	2017	2018	2017
	June 30,	2017	June 30,	2017
	(in thousands)		(in thousands)	
Technology and development	\$134	\$206	\$268	\$414
Sales and marketing	126	190	264	358
General and administrative	277	280	558	551
	\$537	\$676	\$1,090	\$1,323

Edgar Filing: Synacor, Inc. - Form 10-Q

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
Revenue	100%	100%	100%	100%
Costs and operating expenses:				
Cost of revenue ¹	51	46	49	47
Technology and development ¹	17	22	18	25
Sales and marketing	19	20	19	22
General and administrative ¹	12	14	13	14
Depreciation and amortization	7	7	7	8
Total costs and operating expenses	106	109	106	116
Loss from operations	(6)	(9)	(6)	(16)
Other (expense) income	—	—	—	—
Interest income	—	—	—	—
Loss before income taxes	(6)	(9)	(6)	(16)
Income tax provision	—	1	—	1
Net loss	(6)%	(10)%	(6)%	(17)%

Note:

¹Exclusive of depreciation and amortization shown separately

19

Comparison of the three and six months ended June 30, 2018 and 2017:

Revenue

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(in thousands)					
Revenue:						
Search and digital advertising	\$20,978	\$17,969	17	\$40,806	\$31,514	29
Recurring and fee-based	14,945	13,247	13	28,032	26,242	7
Total revenue	\$35,923	\$31,216	15	\$68,838	\$57,756	19
Percentage of Revenue:						
Search and digital advertising	58	% 58	%	59	% 55	%
Recurring and fee-based	42	% 42	%	41	% 45	%
Total revenue	100	% 100	%	100	% 100	%

Three months - 2018 compared to 2017. Revenue in the three months ended June 30, 2018 increased by \$4.7 million, or 15%, compared to the same period in 2017. Search and digital advertising revenue increased by \$3.0 million, or 17% which was primarily due to increased digital advertising revenue attributable to AT&T, partially offset by a decline in other portal advertising revenue.

Recurring and Fee-Based revenue in 2018 increased by \$1.7 million, or 13%, compared to the same period in 2017. This was primarily due to increased hosted email services revenue, portal licensing revenue, and professional services revenue and was offset by a decline due to the effects of the transition of e-mail customers from perpetual to subscription license revenue.

Six months - 2018 compared to 2017. Revenue in the six months ended June 30, 2018 increased by \$11.1 million, or 19%, compared to the same period in 2017. Search and digital advertising revenue increased by \$9.3 million, or 29%. This was primarily due to increased search revenue and digital advertising revenue attributable to AT&T along with increased syndicated advertising revenue.

Recurring and Fee-Based revenue in the six months ended June 30, 2018 increased by \$1.8 million, or 7%, compared to the same period in 2017 primarily due to increased hosted email services revenue, portal licensing revenue, and professional services revenue, which was partially offset by decreased portal valued added services fees and by the effects of the transition of e-mail customers from perpetual to subscription license revenue.

Cost of Revenue

Three Months Ended June 30,	Six Months Ended June 30,
-----------------------------	---------------------------

Edgar Filing: Synacor, Inc. - Form 10-Q

	2018	2017	% Change	2018	2017	% Change
	(in thousands)			(in thousands)		
Cost of revenue	\$18,256	\$14,462	26	\$33,473	\$27,024	24
Percentage of revenue	51	% 46	%	49	% 47	%

Three months - 2018 compared to 2017. Cost of revenue increased by \$3.8 million, or 26% for the three months ended June 30, 2018 as compared to the same period in the prior year. The increase in cost was due primarily to the increased revenue sharing costs, unfavorable changes in our revenue mix as lower-margin syndicated advertising revenue increased as a percentage of revenue, and higher IT infrastructure costs.

Six months - 2018 compared to 2017. Cost of revenue increased by \$6.4 million, or 24% for the six months ended June 30, 2018 as compared to the same period in the prior year. The increase in cost was due primarily to the increase in revenue sharing costs, changes in our revenue mix as lower-margin syndicated advertising revenue increased as a percentage of revenue, and higher IT infrastructure costs.

Technology and Development Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 (in thousands)	2017 (in thousands)	% Change	2018 (in thousands)	2017 (in thousands)	% Change
Technology and development expenses	\$6,069	\$6,904	(12)	\$12,756	\$14,202	(10)
Percentage of revenue	17 %	22 %		18 %	25 %	

Three months - 2018 compared to 2017. Technology and development expenses decreased by \$0.8 million, or 12%, in the three months ended June 30, 2018 as compared to 2017, as a result of lower compensation and consulting expenses in the quarter.

Six months - 2018 compared to 2017. The decrease in the six months ended June 30, 2018 as compared to the same period in 2017 was \$1.4 million, or 10%, and was primarily due to incremental costs incurred in the same period last year related to product development and initial support for the AT&T portal services business along with a \$0.3 million impairment charge recorded in 2017 to write down the value of a software development project to its estimated net realizable value.

Sales and Marketing Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 (in thousands)	2017 (in thousands)	% Change	2018 (in thousands)	2017 (in thousands)	% Change
Sales and marketing	\$6,904	\$6,185	12	\$12,840	\$12,846	(0)
Percentage of revenue	19 %	20 %		19 %	22 %	

Three months - 2018 compared to 2017. Sales and marketing expenses increased by \$0.7 million, or 12%, in the second quarter of 2018 as compared with same period in 2017. The increase was primarily the result of higher sales commissions.

Edgar Filing: Synacor, Inc. - Form 10-Q

Six months - 2018 compared to 2017. Sales and marketing expenses were essentially flat for the first six months of 2018 as compared with same period in 2017. Higher sales commission have been offset by decreases in tradeshows, seminars, and conference expenses.

General and Administrative Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 (in thousands)	2017 (in thousands)	% Change	2018 (in thousands)	2017 (in thousands)	% Change
General and administrative	\$4,320	\$4,361	(1)	\$9,337	\$8,325	12
Percentage of revenue	12 %	14 %		13 %	14 %	

Three months - 2018 compared to 2017. General and administrative expenses were essentially flat for three months ended June 30, 2018 as compared with the same period in 2017. Higher professional service fees were offset by decreases in facilities costs and administrative office expenses.

Six months - 2018 compared to 2017. General and administrative expenses increased by \$1.0 million, or 12%, in the six months ended June 30, 2018 as compared with the same period in 2017. This was primarily due to higher professional service fees which were only partially offset by decreased facility costs and administrative office expenses.

Depreciation and Amortization Expense

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018 (in thousands)	2017 (in thousands)	% Change	2018 (in thousands)	2017 (in thousands)	% Change
Depreciation and amortization	\$2,444	\$2,224	10	\$4,879	\$4,408	11
Percentage of revenue	7	% 7	%	7	% 8	%

Three months - 2018 compared to 2017. Depreciation and amortization increased by \$0.2 million, or 10%, for the three months ended June 30, 2018 as compared to the same period in 2017 as the effect of increased depreciation of leased equipment and capitalized software development costs was partially offset by the effect of assets becoming fully depreciated.

Six months - 2018 compared to 2017. Depreciation and amortization increased by \$0.4 million or 11% for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 as the effect of increased depreciation of capitalized software development costs and increased amortization of intangible assets in 2017 in connection with our 2016 acquisition of Technorati were offset by the effect of assets becoming fully depreciated.

Other (Expense) Income

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018 (in thousands)	2017 (in thousands)	2018 (in thousands)	2017 (in thousands)
Other (expense) income	\$(133)	\$ 67	\$(14)	\$ 73

Other income consists of interest income and foreign currency transaction and measurement gains and losses related to our international operations. The decreases for both the three and six months ended June 30, 2018 over the corresponding periods in 2017 were due to realized foreign currency transaction loss in the second quarter of 2018.

Interest Expense

Edgar Filing: Synacor, Inc. - Form 10-Q

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(in thousands)			(in thousands)		
Interest expense	\$88	\$114	(23)	\$185	\$201	(8)

Interest expense consists of interest on capital leases and long-term debt. Interest expense decreased in both the three and six months ended June 30, 2018 over the comparable periods in 2017 primarily due to the May 2017 pay-off of our bank debt following our public stock offering.

Provision for Income Taxes

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(in thousands)			(in thousands)		
Provision for income taxes	\$293	\$309	(5)	\$313	\$755	(59)

Provision for income taxes of \$0.3 million is comprised primarily of current foreign income tax expense, including foreign withholding taxes, offset by deferred income tax benefit. Prior to 2018, our U.S. deferred income tax assets were offset by valuation allowances, and no benefit was recognized for our net operating losses. Additionally, there was deferred income tax expense due to deferred income tax liabilities related to intangible assets.

The Tax Cuts and Jobs Act eliminated the expiration period for U.S. net operating losses incurred in tax years beginning after 2017. As such, tax losses incurred for tax years beginning after 2017 are available to offset future taxable income that may result from the disposition of indefinite lived intangibles. The reduction of provision for income taxes from \$0.8 million in the six-months ended

June 30, 2017 to \$0.3 million in the six-months ended June 30, 2018 reflects the effects of such deferred income tax benefit offsetting current foreign tax expense.

Liquidity and Capital Resources

Our primary liquidity and capital resource requirements are for financing working capital, investing in capital expenditures such as computer hardware and software, supporting research and development efforts, introducing new technology, enhancing existing technology, and marketing our services and products to new and existing customers.

To the extent that existing cash and cash equivalents, cash from operations, cash from short-term borrowings, and cash from the exercise of stock options are insufficient to fund our future activities, we may need to raise additional funds through public or private equity offerings or debt financings.

In September 2013, we entered into a Loan and Security Agreement with Silicon Valley Bank, or the Lender, which was amended most recently in June 2017 (as amended, the "Loan Agreement"). The amendment temporarily modified the terms of the financial covenants with which we must comply on a quarterly basis. The Loan Agreement provides for a \$12.0 million secured revolving line of credit with a stated maturity of September 27, 2018. The credit facility is available for cash borrowings, subject to a formula based upon eligible accounts receivable. As of June 30, 2018, we had no outstanding borrowings under the Loan Agreement; and we had \$11.4 million of availability based upon the borrowing formula under the Loan Agreement.

Any borrowings under the Loan Agreement bear interest, at our election, at an annual rate based on either the "prime rate" as published in The Wall Street Journal or LIBOR for the relevant period. If our liquidity coverage ratio (the ratio of cash plus eligible accounts receivable to borrowings under the Agreement) exceeds 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 3.5% and prime rate advances bear interest at the prime rate plus 1.0%. If our liquidity coverage ratio falls below 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 4.0% and prime rate advances bear interest at the prime rate plus 1.5%. For LIBOR advances, interest is payable (i) on the last day of a LIBOR interest period or (ii) on the last day of each calendar quarter. For prime rate advances, interest is payable (a) on the first day of each month and (b) on each date a prime rate advance is converted into a LIBOR advance.

Our obligations to the Lender are secured by a first priority security interest in all our assets, including our intellectual property. The Loan Agreement contains customary events of default, including non-payment of principal or interest, violations of covenants, material adverse changes, cross-default, bankruptcy and material judgments. Upon the occurrence of an event of default, the Lender may accelerate repayment of any outstanding balance. The Loan Agreement also contains certain financial covenants and other agreements that are customary in loan agreements of this type, including restrictions on paying dividends and making distributions to our stockholders. As of June 30, 2018, we were in compliance with the covenants and anticipate continuing to be so.

As of June 30, 2018, we had approximately \$14.9 million of cash and cash equivalents. We believe that our existing cash and cash equivalents, along with cash flows from operations and availability under our revolving credit line, will be sufficient to meet our anticipated working capital, interest payments, capital lease payment obligations, and capital expenditure requirements for at least the next 12 months.

Cash Flows

Statement of Cash Flows Data

Edgar Filing: Synacor, Inc. - Form 10-Q

	June 30,	
	2018	2017
	(in thousands)	
Net cash used in operating activities	\$(2,581)	\$(1,476)
Net cash used in investing activities	\$(3,978)	\$(3,576)
Net cash (used in) provided by financing activities	\$(776)	\$13,714

Net Cash Used in Operating Activities

During the six months ended June 30, 2018, net cash used in operating activities of \$2.6 million was primarily driven by a net loss of \$5.0 million and an increase in working capital and other net assets of \$3.5 million which were only partially offset by \$5.9 million of non-cash charges including depreciation, amortization, and stock-based compensation expense.

During the six months ended June 30, 2017, net cash used in operating activities of \$1.5 million was primarily driven by a net loss of \$9.9 million which was only partially offset by a decrease in working capital and other net assets of \$2.1 million and \$6.3 million of non-cash charges including depreciation, amortization, stock-based compensation, and capital software impairment.

Net Cash Used in Investing Activities

Net cash used in investing activities totaled \$3.9 million in the six months ended June 30, 2018, as compared to \$3.6 million in the comparable 2017 period. Cash payments were primarily for the development of internal-use software.

Net Cash (Used in) Provided by Financing Activities

Net cash used in financing activities for the six months ended June 30, 2018 of \$0.8 million consisted of \$0.9 million of payments on capital lease obligations less \$0.1 million of proceeds from exercise of stock options.

Net cash provided by financing activities for the six months ended June 30, 2017 of \$13.7 million primarily consisted of \$20 million from the offering of common stock and \$0.8 million of proceeds from the exercise of stock options, offset by a \$5.0 million repayment of long-term debt, \$1.3 million of deferred acquisition payments and \$0.7 million of payments on capital lease obligations.

Off-Balance Sheet Arrangements

As of June 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a) (4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenue, or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These primarily include interest rate, inflation, and foreign currency exchange risk.

Interest Rate Risk

Our cash and cash equivalents primarily consist of cash and money market funds. We currently have no investments of any type. Our exposure to market risk for changes in interest rates is limited because nearly all of our cash and cash equivalents have a short-term maturity and are used primarily for working capital purposes.

Funds borrowed under this facility bear interest at a variable annual rate, at our election, based on either the “prime rate” as published in The Wall Street Journal or LIBOR for the relevant period. If our liquidity coverage ratio (the ratio of cash plus eligible accounts receivable to bank borrowings under the related loan agreement) exceeds 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 3.5% and prime rate advances bear interest at the prime rate plus 1.0%. If our liquidity coverage ratio falls below 2.75 to 1, LIBOR-based advances bear interest at LIBOR plus 4.0% and prime rate advances bear interest at the prime rate plus 1.5%. This arrangement subjects us to interest rate risk. A 10% increase or decrease in these interest rates would not have a significant impact on our interest expense. Refer to Note 5, Long-Term Debt, of the Notes to the Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2017 for additional information about our outstanding debt.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able 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.

Foreign Currency Exchange Risks

We are also subject to foreign currency exchange risk relating to our operations in Canada, Europe, India, Japan and Singapore. Our expenses at these locations are denominated in the local currencies and our results of operations are influenced by changes in the exchange rates between the U.S. Dollar and these local currencies, principally the Canadian Dollar, Euro, British Pound Sterling, Rupee, Yen, and Singapore Dollar. In addition, certain of our accounts receivable are denominated in currencies other than the U.S. Dollar, principally the Euro, British Pound Sterling, and Japanese Yen. A 10% increase or decrease in the applicable currency exchange rates could result in an increase or decrease in our currency exchange (loss) gain of approximately \$0.2 million, calculated based on our foreign currency denominated accounts receivable as of June 30, 2018.

We have in the past, and we may in the future, enter into contracts to minimize the foreign currency exchange risk with respect to significant foreign currency denominated accounts receivable balances.

We continue to evaluate our various foreign currency exchange rate exposures and may take additional steps to mitigate these exposures.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Based on our management’s evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018, our disclosure controls and procedures were not effective because of certain material weaknesses in our internal control over financial reporting, as further described in our Annual Report on Form 10-K for our fiscal year ended December 31, 2017.

Notwithstanding these material weaknesses, we have concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material respects, our financial position and results of operations and cash flows for the periods presented.

Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Remediation Efforts to Address the Material Weaknesses

We take these material weaknesses very seriously. While the material weaknesses were not remediated as of June 30, 2018, we have taken steps to remediate them and will continue to take further steps until their remediation is complete. For example, we have assigned additional personnel within our finance department to assist with the implementation, administration and evaluation of our internal control over financial reporting. These additional personnel include certified public accountants and persons with experience in financial and accounting project management, to augment the experience and expertise of our accounting team. In addition, we hired a Finance Manager and a Senior VP-Finance in 2018, both of whom are certified public accountants. We have also engaged an outside public accounting firm to provide us with the services of accounting support personnel and will continue to use their services on an as-needed basis.

Additionally, with the assistance of the outside public accounting firm, we are expanding and enhancing the written documentation of our internal controls, including assigning more specific responsibilities to particular personnel and imposing shorter timelines for executing their control-related tasks. The senior members of our finance department will be responsible for holding other members of the department accountable for meeting such timelines. We believe that this additional oversight, coupled with the additional personnel devoted to internal control over financial reporting, will allow us to execute business process controls more quickly and ensure a greater level of monitoring whether controls are present and functioning.

Changes in Internal Control over Financial Reporting

There were no other changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the quarter ended June 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

25

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We and two of our executive officers were recently named as defendants in a putative securities class action lawsuit filed April 4, 2018 in the United States District Court for the Southern District of New York. The complaint makes various allegations regarding statements related to the contractual arrangement between us and AT&T, and the effect of that arrangement on our revenue. The complaint seeks unspecified damages, interest, and other costs. The court appointed a lead plaintiff and approved plaintiff's selection of lead counsel on July 6, 2018. On August 2, 2018, plaintiffs filed an amended complaint asserting the same claims arising from similar allegations as the first complaint. Our pre-motion letter regarding its anticipated motion to dismiss the amended complaint is due on August 17, 2018. We dispute these claims and will defend vigorously against any allegations of wrongdoing.

In addition, from time to time we may become involved in legal proceedings arising in the ordinary course of our business. Although the results of legal proceedings and claims cannot be predicted with certainty, including the matters noted above, based on advice of counsel we believe we are not presently involved in any legal proceedings, the outcome of which, if determined adversely to us, would be expected to have a material adverse effect on our business, results of operations or financial condition. However, regardless of the outcome, such proceedings can have an adverse impact on us because of defense and settlement costs, diversion of resources and other factors.

ITEM 1A. RISK FACTORS

Our business and financial results are subject to numerous risks and uncertainties, including those described below, which could adversely and materially affect our business, financial condition or results of operations. You should carefully consider these risks and uncertainties, including the following risk factors and all other information contained in this Quarterly Report on Form 10-Q, together with any other documents we file with the SEC.

Risks Related to Our Business

A loss of any significant Managed Portals and Advertising customer could negatively affect our financial performance.

Although we have diversified our product portfolio and our customer base, we continue to derive a substantial portion of our revenue from a small number of Managed Portal customers. Revenue attributable to these customers includes the Recurring and Fee-Based revenue earned directly from them, as well as the search and digital advertising revenue earned through our relationships with our advertising partners, such as Google, based on traffic generated from our Managed Portals. For the six months ended June 30, 2018, revenue attributable to one customer (AT&T), accounted for approximately 28% of our revenue, or \$19 million; no other customer accounted for 10% or greater of our revenue in the quarter.

Our contracts with our Managed Portals and Advertising customers generally have an initial term of approximately two to three years from the launch of their Managed Portals and frequently provide for one or more automatic renewal terms of one to two years each. If a key contract is not renewed or is otherwise terminated, or if revenue from a significant customer declines because of competitive or other reasons, including the customer's desire to reprioritize or deemphasize monetization of the portal, our revenue would decline and our ability to achieve or sustain profitability would be impaired. In addition to the loss of Recurring and Fee-Based revenue, we would also lose significant revenue from the related search and digital advertising services that we provide. In addition to the decline of revenue, we may have to impair our long-lived assets, to the extent that such assets are used exclusively to support these customers, which would adversely impact our results of operations and financial position.

We derive a substantial portion of our revenue from AT&T, with revenue from AT&T exceeding the revenue attributable to any of our other customers. If our contract with AT&T is not renewed or is otherwise terminated, or if revenue from the AT&T relationship were to decline due to competitive or other reasons, our results of operations and financial position would be adversely affected.

Our search advertising partner, Google, accounts for a significant portion of our revenue, and any loss of, or diminution in, our business relationship with Google would adversely affect our financial performance.

We rely on traffic on our Managed Portals to generate search and digital advertising revenue, a substantial portion of which is derived from text-based links to advertisers' websites as a result of internet searches. We have a revenue-sharing relationship with Google under which we include a Google-branded search tool on our Managed Portals. When a consumer makes a search request using this tool, we deliver it to Google, and Google returns search results to us that include advertiser-sponsored links. If the consumer clicks on a sponsored link, Google receives payment from the sponsor of that link and shares a portion of that payment with us. We then typically share a portion of that payment with the applicable customer. Our Google-related search advertising revenue attributable to our customers, which consists of the portion of the payment from the sponsor that Google shares with us, accounted for approximately 14%, 12%, and 28% of our revenue in 2017, 2016, and 2015 or \$20.1 million, \$15.9 million, and \$31.2 million, respectively, and approximately 14% of our revenue in the six months ended June 30, 2018, or \$9.8 million. We recently renewed our

agreement with Google for a two year period ending May 31, 2020. Additionally, Google may terminate our agreement if we experience a change in control, if we enter into an agreement providing for a change in control, if we do not maintain certain search and digital advertising revenue levels or if we fail to conform to Google's search policies and advertising policies. Google may from time to time change its existing, or establish new, methodologies and metrics for valuing the quality of internet traffic. Any changes in these methodologies, metrics and advertising technology platforms could decrease the advertising rates that we receive and/or the amount of revenue that we generate from digital advertisements. If advertisers were to discontinue their advertising via internet searches, if Google's revenue from search-based advertising were to decrease, if Google's share of the search revenue were to be increased or if our agreement with Google were to be terminated for any reason or renewed on less favorable terms, our business, financial condition and results of operations would be adversely affected. Moreover, consumers' increased use of search tools other than the Google-branded search tool we provide would have similar effects.

We have a history of significant pre-tax net losses and may not be profitable in future periods.

We have reported pre-tax net income in only three years, 2009, 2011 and 2012, in amounts of \$0.3 million, \$3.9 million, and \$5.6 million, respectively. In all other years, we have incurred losses, and at June 30, 2018 our cumulative net operating loss carryforward totaled approximately \$31.2 million, including a pre-tax net loss of \$4.6 million in the six months ended June 30, 2018. We have previously taken cost saving measures and we continue to look for ways to reduce costs and streamline operations. However, our expenses have increased and may increase in future periods as we implement initiatives designed to grow our business including, among other things, the ongoing costs and expenses we must incur in connection with providing Managed Portal and Advertising solutions to AT&T, acquisitions of complementary businesses (such as our acquisition of the Zimbra assets and our acquisition of assets from Technorati), the development and marketing of new services and products, licensing of content, expansion of our infrastructure and international expansion. If our revenue does not sufficiently increase to offset these expected increases in operating expenses, or if we are not able to sufficiently reduce costs in the event our revenue increases fail to materialize, we may incur significant losses and may not be profitable. For example, although our revenue in 2017 increased as compared to 2016 and our revenue in 2016 increased as compared to 2015, we have not yet returned to profitability. We may not be able to return to or maintain profitability in the future. Any failure to achieve or maintain profitability may adversely affect our business, financial condition, results of operations and impact our ability to utilize our net operating loss carryforwards. As a result of our pre-tax cumulative losses, we have established a full valuation allowance against our net deferred income tax asset, which includes our net operating loss carryforwards.

Many individuals are using devices other than personal computers and software applications other than internet browsers to access the internet. If users of these devices and software applications do not widely adopt the applications and other solutions we develop for them, our business could be adversely affected.

The number of people who access the internet through devices other than PCs, including tablets, smartphones and connected TVs, has increased dramatically and is projected to continue to increase. Similarly, individuals are increasingly accessing the internet through apps other than internet browsers, such as those available for download through Apple Inc.'s App Store and the Android Market. Our Managed Portals include our responsive desktop and mobile web products and also our mobile native iOS and Android apps. The Managed Portal solutions we have developed for our AT&T relationship include solutions for mobile products as well as desktop computers. If consumers do not use our mobile products at all or use these products less frequently than previously, our financial results could be negatively affected. Additionally, as new devices and new apps are continually being released, it is difficult to predict the problems we may encounter in developing new versions of our apps and other solutions for use on these alternative devices and apps, and we may need to devote significant resources to the creation, support and maintenance of such apps and solutions. If users of these devices and apps do not widely adopt the apps and other solutions we develop, our business, financial condition and results of operations could be adversely affected.

Consumer tastes continually change and are unpredictable, and sales of our Managed Portals and Advertising solutions may decline if we fail to enhance our service and content offerings to achieve continued consumer acceptance.

Our business depends on aggregating and providing services and content that our customers will place on our Managed Portals, including television programming, news, entertainment, sports and other content that their consumers find engaging, and premium services and paid content that their consumers will buy. Accordingly, we must continue to invest significant resources in licensing efforts, research and development and marketing to enhance our service and content offerings, and we must make decisions about these matters well in advance of product releases to implement them in a timely manner. Our success depends, in part, on unpredictable and volatile factors beyond our control, including consumer preferences, competing content providers and websites and the availability of other news, entertainment, sports and other services and content. While we work with our customers to have their consumers' homepages set to our Managed Portals, a consumer may easily change that setting, which would likely decrease the use of our Managed Portals. Similarly, consumers who change their device's operating system or internet browser may no longer have our Managed Portals set as their default homepage, and unless they change it back to our Managed Portals, their usage of our Managed Portals would likely decline and our results of operations could be negatively impacted. Consumers who acquire new consumer electronics devices no longer have our Managed Portals initially set as their default homepage, and unless they change the default to

our Managed Portals, their usage of our Managed Portals would likely decline and our results of operations could be negatively impacted.

If our services are not responsive to the requirements of our customers or the preferences of their consumers, or the services are not brought to market in a timely and effective manner, our business, financial condition and results of operations would be harmed. Even if our services and content are successfully introduced and initially adopted, a subsequent shift in the preferences of our customers or their consumers could cause a decline in the popularity of our services and content that could reduce our revenue and harm our business, financial condition and results of operations.

Our revenue growth will be adversely affected if we are unable to expand the breadth of our services and products or to introduce new services and products on a timely basis.

To retain our existing customers, attract new customers and increase revenue, we must continue to develop and introduce new services and products on a timely basis and continue to develop additional features to our existing product base. For example, under our relationship with AT&T, we agreed to deliver a number of additional products and services to AT&T's consumers. If our existing and prospective customers do not perceive that we will deliver our services and products on schedule, or if they do not perceive our services and products to be of sufficient value and quality, we may lose the confidence of our existing customers and fail to increase sales to these existing customers, existing customers may be able to terminate their agreements with us, and we may not be able to attract new customers, each of which would adversely affect our operating results.

Our sales cycles and the contracting process with new customers are long and unpredictable and may require us to incur expenses before executing a customer agreement, which makes it difficult to project when, if at all, we will obtain new customers and when we will generate additional revenue and cash flows from those customers.

We market our services and products directly to high-speed internet service and communications providers, consumer electronics manufacturers, and directly and indirectly to enterprises, and governmental and nonprofit organizations. New customer relationships typically take time to obtain and finalize because of the burdensome cost of migrating from an existing solution to our platform. Due to operating procedures in many organizations, a significant time period may pass between selection of our services and products by key decision-makers and the signing of a contract. The length of time between the initial customer sales call and the realization of significant sales is difficult to predict and can range from several months to several years. As a result, it is difficult to predict when we will obtain new customers and when we will begin to generate revenue and cash flows from these potential new customers.

As part of our sales cycle for our Managed Portals and Advertising customers, we may incur significant expenses in the form of compensation and related expenses and equipment acquisition before executing a definitive agreement with a prospective customer so that we may be ready to launch shortly following execution of a definitive agreement. If conditions in the marketplace generally or with a specific prospective customer change negatively, it is possible that no definitive agreement will be executed, and we will be unable to recover any expenses incurred before a definitive agreement is executed, which would in turn have an adverse effect on our business, financial condition and results of operations.

Many of our customers are high-speed internet service providers, and consolidation within the cable and telecommunications industries could adversely affect our business, financial condition and results of operations.

Our revenue from high-speed internet service and communications providers, including our search and digital advertising revenue generated by online consumer traffic on our Managed Portals and our revenue from our Email/Collaboration offerings, accounted for approximately 63% in 2017, approximately 63% in 2016, approximately

82% in 2015, and approximately 84% in the six months ended June 30, 2018. The cable and telecommunications industries have experienced consolidation over the past several years, and we expect that this trend will continue. As a result of consolidation, some of our customers may be acquired by companies with which we do not have existing relationships and which may have relationships with one of our competitors or may have the in-house capacity to perform the services we provide. As a result, such acquisitions could cause us to lose customers and the associated revenue. Under our agreements with some of our customers, including CenturyLink, they have the right to terminate the agreement if we are acquired by one of their competitors.

Consolidation may also require us to renegotiate our agreements with our customers as a result of enhanced customer leverage. We may not be able to offset the effects of any such renegotiations, and we may not be able to attract new customers to counter any revenue declines resulting from the loss of customers or their subscribers.

We rely, to a significant degree, on indirect sales channels for the distribution of our Email/Collaboration products, and disruption within these channels could adversely affect our business, financial condition, operating results and cash flows.

We use a variety of indirect distribution methods for our offerings, including channel partners, such as cloud service providers, distributors, and value added resellers. A number of these partners in turn distribute our offerings via their own networks of channel partners with whom we have no direct relationship. These relationships allow us to offer our technologies to a much larger customer base than we would otherwise be able through our direct sales and marketing efforts.

We rely, to a significant degree, on each of our channel partners to select, screen and maintain relationships with its distribution network and to distribute our offerings in a manner that is consistent with applicable law and regulatory requirements and our quality standards. If our channel partners or a partner in its distribution network violate applicable law or regulatory requirements or misrepresent the functionality of our offerings, our reputation could be damaged and we could be subject to potential liability. Furthermore, our channel partners may offer their own products and services that are competitive with our offerings or may not distribute and market our offerings effectively. Our existing channel partner relationships do not, and any future channel partner relationships may not, afford us any exclusive marketing or distribution rights. In addition, if a channel partner is acquired by a competitor or its business units are reorganized or divested, our revenue derived from that partner may be adversely impacted.

Recruiting and retaining qualified channel partners and training them in the use of our technologies require significant time and resources. If we fail to devote sufficient resources to support and expand our network of channel partners, our business may be adversely affected. In addition, because we rely on channel partners for the indirect distribution of our technologies, we may have little or no contact with the ultimate end-users of our technologies, thereby making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our software, support ongoing customer requirements, estimate end-user demand, respond to evolving customer needs and obtain renewals from end-users.

Most of our sales to government entities have been made indirectly through our channel partners. Government entities may have statutory, contractual, or other legal rights to terminate contracts with our channel partners for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government refusing to continue buying our offerings, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities.

If our indirect distribution channel is disrupted, we may be required to devote more resources to distribute our offerings directly and support our customers, which may not be as effective and could lead to higher costs, reduced revenue and growth that is slower than expected.

As technology continues to evolve, the use of our products by our current and prospective consumer electronics manufacturer customers may decrease and our business could be adversely affected.

The consumer electronics industry is subject to rapid change, and our contracts for Managed Portals and Advertising solutions with our consumer electronics manufacturer customers are not exclusive. As consumer electronics manufacturers continue to develop new technologies and introduce new models and devices, there can be no assurance that we will be able to develop solutions that will persuade consumer electronics manufacturers that are our customers at such time to utilize our technology for those new devices. If our current and prospective consumer electronics manufacturer customers elect not to integrate our solutions into their new products, our business, financial condition and results of operations could be adversely affected.

Moreover, updates to internet browser technology may adversely affect our business. For example, for our consumer electronics manufacturer customers that have the Windows 8 operating system pre-installed on some of their devices, the Windows 8 operating system places our Managed Portal on a second tab when the internet browser is launched, leading to decreased search and digital advertising revenue. Further, upgrades to the Windows 10 operating system default to Microsoft's latest Edge browser and displace users' previous browser settings including default homepages, which can also lead to decreased search and digital advertising revenue. Unless consumers change their browser settings back to our Managed Portals, their usage of our Managed Portals would likely decline and our results of operations could be negatively impacted.

We invest in features and functionality designed to increase consumer engagement with our Managed Portals; however, these investments may not lead to increased revenue.

Our future growth and profitability will depend in large part on the effectiveness and efficiency of our efforts to provide a compelling consumer experience that increases consumer engagement with our Managed Portals. We have made and will continue to make substantial investments in features and functionality for our technology that are designed to drive consumer engagement. For example, as of June 30, 2018 we have invested over \$10 million in the aggregate in start-up expenses, development expenses and capital expenditures relating to our contract with AT&T, and we expect to continue to invest in features and functionality in connection with obtaining new customers.

Not all of these activities directly generate revenue, and we cannot assure you that we will reap sufficient rewards from these investments to make them worthwhile. If the expenses that we incur in connection with these activities do not result in increased consumer engagement that in turn results in revenue increases that exceed these expenses, our business, financial condition and results of operations will be adversely affected.

Our services and products may become less competitive or even obsolete if we fail to respond to technological developments.

Our future success will depend, in part, on our ability to modify or enhance our services and products to meet customer and consumer needs, to add functionality and to address technological advancements that would improve their performance. For example, if our smartphone and tablet products fail to capture the increased search activity on such devices or if our services and products do not adapt to the increasing video usage on the internet or to take into account evolving developments in social networking, then they could begin to appear obsolete. Similarly, if we fail to develop new ways to deliver content and services through apps other than traditional internet browsers, consumers could seek alternative means of accessing content and services.

To remain competitive, we will need to develop new services and products and adapt our existing ones to address these and other evolving technologies and standards. However, we may be unsuccessful in identifying new opportunities or in developing or marketing new services and products in a timely or cost-effective manner. In addition, our product innovations may not achieve the market penetration or price levels necessary for profitability. If we are unable to develop enhancements to, and new features for, our existing services and products or if we are unable to develop new services and products that keep pace with rapid technological developments or changing industry standards, our services and products may become obsolete, less marketable and less competitive, and our business will be harmed.

We depend on third parties for content that is critical to our business, and our business could suffer if we do not continue to obtain high-quality content at a reasonable cost.

We license the content that we aggregate on our Managed Portals from numerous third-party content providers, and our future success is highly dependent upon our ability to maintain and enter into new relationships with these and other content providers. In some cases, we are required under our contracts, including our contract with AT&T, to provide our customers' consumers access to certain types of content. In the future, some of our content providers may not give us access to high-quality content, may fail to adapt to changes in consumer tastes or may increase the royalties, fees or percentages that they charge us for their content, any of which could have an adverse effect on our operating results. Our rights to the content that we offer to our customers and their consumers are not exclusive, and the content providers could license their content to our competitors. Our content providers could even grant our competitors exclusive licenses. In addition, our customers are not prohibited from entering into content deals directly with our content providers. Any failure to enter into or maintain satisfactory arrangements with content providers would adversely affect our ability to provide a variety of attractive services and products to our customers. Our reputation and operating results could suffer as a result, and it may be more difficult for us to develop new relationships with potential customers.

Our Zimbra Email/Collaboration solution was developed as an open-source software product. As such, it may be relatively easy for competitors, some of which may have greater resources than we have, to compete with us.

One of the characteristics of open source software is that anyone may modify and redistribute the existing open source software and use it to compete with us. Such competition can develop without the degree of overhead and lead time required by traditional software, internet or technology companies. In addition, some of these competitors may make their open source software available for free download and use on an ad hoc basis or may position their open source

software as a loss leader. We cannot guarantee that we will be able to compete successfully against current and future competitors or that competitive pressure and/or the availability of open source software will not result in price reductions, reduced operating margins and loss of market share, any one of which could adversely affect our business, financial condition, operating results and cash flows.

In 2016, we announced an initiative to promote support for our open source Zimbra Email/Collaboration solution with the expectation that the initiative would lead to increased maintenance, support and professional service revenue, and we received our first customer orders for maintenance and support services related to the open source solution. However, there can be no assurance that this initiative will yield a material increase in revenue.

Our revenue and operating results may fluctuate, which makes our results difficult to predict and could cause our results to fall short of expectations.

As a result of the rapidly changing nature of the markets in which we compete, our quarterly and annual revenue and operating results are likely to fluctuate from period to period. These fluctuations may be caused by a number of factors, many of which are beyond our control, including but not limited to the various factors set forth in this “Risk Factors” section, as well as:

- any failure to maintain strong relationships and favorable revenue-sharing arrangements with our Managed Portals and Advertising partners, in particular Google, including a reduction in the quantity or pricing of sponsored links that consumers click on or a reduction in the pricing of digital advertisements by advertisers;
- the timing of our investment in, or the timing of our monetization of, our products and services;
- any failure of significant customers to renew their agreements with us;
- our ability to attract new customers;
- our ability to increase sales of premium services and paid content to our existing customers’ consumers;
- any development by our significant customers of the in-house capacity to replace the solutions we provide;
 - the release of new product and service offerings by our competitors or our customers;
- variations in the demand for our services and products and the implementation cycles of our services and products by our customers;
- changes to internet browser technology that may render our Managed Portals less competitive;
- changes in our pricing policies or those of our competitors;
- changes in the prices our customers charge their consumers for email, premium services and paid content;
- service outages, other technical difficulties or security breaches;
- limitations relating to the capacity of our networks, systems and processes;
- our failure to accurately estimate or control costs, including costs related to the implementation of our solutions for new customers;
- maintaining appropriate staffing levels and capabilities relative to projected growth;
- the timing of costs related to the development or acquisition of technologies, services or businesses to support our existing customers and potential growth opportunities; and
- general economic, industry and market conditions and those conditions specific to internet usage and online businesses.

For these reasons and because the market for our services and products is relatively new and rapidly changing, it is difficult to predict our future financial results.

Expansion into international markets, which is an important part of our strategy, but where we have limited experience, will subject us to risks associated with international operations.

We plan to continue to expand our product offerings internationally, particularly in Asia, Canada, Latin America and Europe. Although our exposure to and expertise in international markets have increased as a result of our acquisition of the Zimbra assets in September 2015, we still have limited experience in marketing and operating all of our services and products in international markets, and we may not be able to successfully develop or grow our business in these markets. Our success in these markets will be directly linked to the success of our relationships with potential customers, resellers, content partners and other third parties.

As the international markets in which we operate continue to grow, we expect that competition in these markets will intensify. Local companies may have a substantial competitive advantage because of their greater understanding of, and focus on, the local markets. Some of our domestic competitors who have substantially greater resources than we do may be able to more quickly and comprehensively develop and grow in international markets. International

expansion may also require significant financial investment including, among other things, the expense of developing localized products, the costs of acquiring foreign companies and the integration of such companies with our operations, expenditure of resources in developing customer and content relationships and the increased costs of supporting remote operations.

Other risks of doing business in international markets include the increased risks and burdens of complying with different legal and regulatory regimes and standards, difficulties in managing and staffing foreign operations, recruiting and retaining talented direct sales personnel, limitations on the repatriation of funds and fluctuations of foreign exchange rates, varying levels of internet technology adoption and infrastructure and our ability to enforce contracts and our intellectual property rights in foreign jurisdictions. In addition, our success in international expansion could be limited by barriers to international expansion such as tariffs, adverse tax consequences and technology export controls. If we cannot manage these risks effectively, the costs of doing business in some international markets may be prohibitive or our costs may increase disproportionately to our revenue. Some of our business partners also have international operations and are subject to the risks described above. Even if we are able to successfully manage the risks of international operations, our business may be adversely affected if our business partners are not able to successfully manage these risks.

Failure to comply with the United States Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.

We are subject to the United States Foreign Corrupt Practices Act, which generally prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices may occur with respect to our expansion into international markets. Our employees or other agents may engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences, including adverse publicity and damage to our reputation that may have an adverse effect on our business, financial condition and results of operations.

Our agreements with some of our customers, content providers and service providers require fixed payments, which could adversely affect our financial performance.

Certain of our agreements with Managed Portals and Advertising customers and content providers require us to make fixed payments to them. As of June 30, 2018, the aggregate amount of such fixed payments for the remaining six months of 2018 through 2020 total approximately \$2.6 million. We are required to make these fixed payments regardless of the achievement of any revenue objectives or subscriber or usage levels. If we do not achieve our financial objectives, these contractual commitments would constitute a greater percentage of our revenue than originally anticipated and would adversely affect our profitability.

Our agreements with some of our customers and content providers contain penalties for non-performance, which could adversely affect our financial performance.

We have entered into service level agreements with many of our customers. These agreements generally call for specific system “up times” and 24 hours per day, seven days per week support and include penalties for non-performance. We may be unable to fulfill these commitments due to circumstances beyond our control, which could subject us to substantial penalties under those agreements, harm our reputation and result in a reduction of revenue or the loss of customers, which would in turn have an adverse effect on our business, financial condition and results of operations. To date, we have never incurred any material penalties. In addition, certain of our agreements with customers contain penalties for certain types of non-performance which, if not timely rectified, could result in substantial financial penalties to us.

System failures or capacity constraints could harm our business and financial performance.

The provision of our services and products depends on the continuing operation of our information technology and communications systems. Any damage to or failure of our systems could result in interruptions in our service. Such

interruptions could harm our business, financial condition and results of operations, and our reputation could be damaged if people believe our systems are unreliable. Our systems are vulnerable to damage or interruption from snow storms, terrorist attacks, floods, fires, power loss, telecommunications failures, security breaches, computer malware, computer hacking attacks, computer viruses, computer denial of service attacks or other attempts to, or events that, harm our systems. Our data centers are also subject to break-ins, sabotage and intentional acts of vandalism and to potential disruptions if the operators of the facilities have financial difficulties. Although we maintain insurance to cover a variety of risks, the scope and amount of our insurance coverage may not be sufficient to cover our losses resulting from system failures or other disruptions to our online operations. For example, the limit on our business interruption insurance is approximately \$26 million for cyber loss (and \$38 million for physical loss). Any system failure or disruption and any resulting losses that are not recoverable under our insurance policies may harm our business, financial condition and results of operations. To date, we have never experienced any material losses.

Not all of our data centers are on full second-site redundancy; only certain customers require this capability. We regularly back-up our systems and store the system back-ups in Atlanta, Georgia; Watertown, Massachusetts; Dallas and Allen, Texas; Lewis Center, Ohio; Denver, Colorado; Toronto, Canada; and Amsterdam, the Netherlands. If we were forced to relocate to an alternate site and to rely on our system back-ups to restore the systems, we would experience significant delays in restoring the functionality of our platform and could experience loss of data, which could harm our business and our operating results.

Security breaches, computer viruses and computer hacking attacks could harm our business, financial condition and results of operations.

Security breaches, computer malware and computer hacking attacks are prevalent in the technology industry. Any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, and the inadvertent transmission of computer viruses could harm our business, financial condition and results of operations. We have previously experienced hacking attacks on our systems, and may in the future experience hacking attacks. We may be unable to implement adequate preventative measures against or proactively address techniques used to obtain unauthorized access, disable or degrade service or sabotage systems. Though it is difficult to determine what harm may directly result from any specific interruption or breach, any failure to maintain performance, reliability, security and availability of our technology infrastructure to the satisfaction of our customers and their consumers may harm our reputation and our ability to retain existing customers and attract new customers.

We may not maintain acceptable website performance for our Managed Portals and Advertising customers, which may negatively impact our relationships with our customers and harm our business, financial condition and results of operations.

A key element to our continued growth is the ability of our customers' consumers in all geographies to access our Managed Portals and other offerings within acceptable load times. We refer to this as website performance. We may in the future experience platform disruptions, outages and other performance problems due to a variety of factors, including infrastructure changes, human or software errors, capacity constraints due to an overwhelming number of users accessing our technology simultaneously, and denial of service or fraud or security attacks.

In some instances, we may not be able to identify the cause or causes of these website performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve website performance, especially during peak usage times, and as our solutions become more complex and our user traffic increases. If our Managed Portals and Advertising solutions are unavailable when consumers attempt to access them or do not load as quickly as they expect, consumers may seek other alternatives to obtain the information for which they are looking, and may not use our products and services as often in the future, or at all. This would negatively impact our relationships with our customers. We expect to continue to make significant investments to maintain and improve website performance. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be harmed.

We rely on our management team and need additional personnel to expand our business, and the loss of key officers or an inability to attract and retain qualified personnel could harm our business, financial condition and results of operations.

We depend on the continued contributions of our senior management and other key personnel, especially Himesh Bhise, our President and Chief Executive Officer, Timothy J. Heasley, our Chief Financial Officer, and Steven M. Davi, our Executive Vice President of Technology. The loss of the services of any of our executive officers or other key employees could harm our business and our prospects. All of our executive officers and key employees are at-will employees, which means they may terminate their employment relationship with us at any time.

Our future success also depends on our ability to identify, attract and retain highly skilled technical, managerial, finance, marketing and creative personnel. Further, we will need to hire personnel outside the United States to continue to pursue an international expansion strategy. We face intense competition for qualified individuals from numerous technology, marketing and media companies, and we may incur significant costs to attract them. We may

be unable to attract and retain suitably qualified individuals, or we may be required to pay increased compensation in order to do so. If we were to be unable to attract and retain the qualified personnel we need to succeed, our business could suffer.

Volatility or lack of performance in the trading price of our common stock may also affect our ability to attract and retain qualified personnel. Many of our senior management personnel and other key employees have become, or will become, vested in a substantial amount of stock or stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options or if the exercise prices of the options that they hold are significantly above the trading price of our common stock. If we are unable to retain our employees, our business, financial condition and results of operations would be harmed.

If we fail to manage our growth effectively, our business, financial condition and results of operations may suffer.

Through much of our history, our business expansion had resulted from organic growth. More recently, however, we have sought to, and may continue to seek to, grow through strategic acquisitions. For example, in the first quarter of 2016, we acquired certain assets from Technorati, and in 2015, we acquired the Zimbra assets and certain assets of NimbleTV. Our goal of returning to growth may place significant demands on our management and our operational and financial infrastructure. Our ability to manage our growth effectively and to integrate new technologies and acquisitions (such as the assets acquired from Technorati, Zimbra, and NimbleTV) into our existing business will require us to continue to expand our operational, financial and management information systems and to continue to retain, attract, train, motivate and manage key employees. Growth could strain our ability to:

- develop and improve our operational, financial and management controls;
- enhance our reporting systems and procedures;
- recruit, train and retain highly skilled personnel;
- maintain our quality standards; and
- maintain customer and content owner satisfaction.

Managing our growth will require significant expenditures and allocation of valuable management resources. If we fail to achieve the necessary level of efficiency in our organization as it grows, our business, financial condition and results of operations would be harmed.

We may expand our business through acquisitions of, or investments in, other companies or new technologies, or joint ventures or other strategic alliances with other companies, which may divert our management's attention or prove not to be successful.

In February 2016, we acquired substantially all of the assets of, and hired certain personnel from, Technorati; and in 2015, we acquired the Zimbra assets and hired certain related personnel and we purchased assets from, and hired the personnel of, NimbleTV. We may decide to pursue other acquisitions of, investments in, or joint ventures involving other technologies and businesses in the future. Such transactions could divert our management's time and focus from operating our business.

Our ability as an organization to integrate acquisitions is relatively unproven. Integrating an acquired company, business or technology is risky and may result in unforeseen operating difficulties and expenditures, including, among other things, with respect to:

- incorporating new technologies into our existing business infrastructure;
- consolidating corporate and administrative functions;
- coordinating our sales and marketing functions to incorporate the new business or technology;
- maintaining morale, retaining and integrating key employees to support the new business or technology and managing our expansion in capacity; and
- maintaining standards, controls, procedures and policies (including effective internal control over financial reporting and disclosure controls and procedures).

In addition, a significant portion of the purchase price of companies we may acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our earnings based on this impairment assessment process, which could harm our operating results.

Future acquisitions could result in potentially dilutive issuances of our equity securities, including our common stock, or the incurrence of debt, contingent liabilities, amortization expenses or acquired in-process research and

development expenses, any of which could harm our business, financial condition and results of operations. Future acquisitions may also require us to obtain additional financing, which may not be available on favorable terms or at all.

34

We may require additional capital to grow our business, and this capital may not be available on acceptable terms or at all.

The operation of our business and our growth strategy may require significant additional capital, especially if we were to accelerate our expansion and acquisition plans. For example, we invested more than \$10.0 million in 2016 and 2017 in operating expenses and capital expenditures in preparing to support AT&T as a customer, and an additional \$4.6 million in 2017 in the development of internal-use software and software for sale or license to other customers. If the cash generated from operations and otherwise available to us is not sufficient to meet our capital requirements, we will need to seek additional capital, potentially through debt or equity financings, to fund our growth. We may not be able to raise needed capital on terms acceptable to us or at all. Financings, if available, may be on terms that are dilutive or potentially dilutive to our stockholders, and the prices at which new investors would be willing to purchase our securities may cause our existing stockholders to suffer substantial dilution. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our common stock. As with our credit facility with Silicon Valley Bank, any debt financing obtained by us in the future could contain financial or other covenants that may potentially restrict our operations, and if we do not effectively manage our business to comply with those covenants, our business, financial condition and results of operations could be adversely affected.

While we successfully raised approximately \$20.0 million in an underwritten public offering of 6,187,846 shares of our common stock in April and May of 2017, the net proceeds of that offering may not be sufficient to meet our objectives, including funding our growth plans and potential acquisitions as they may arise.

In addition, while we are in compliance at June 30, 2018 with the financial covenants contained in our credit facility with Silicon Valley Bank, our future financial performance, including our future capital expenditures, may potentially cause us to become not in compliance with those covenants, possibly restricting our ability to continue to borrow under our credit facility.

If new or existing sources of financing are required but are insufficient or unavailable, we could be required to delay, abandon or otherwise modify our growth and operating plans to the extent of available funding, which would harm our ability to grow our business.

Our business depends, in part, on our ability to protect and enforce our intellectual property rights.

The protection of our intellectual property and other proprietary rights is critical to our success. We rely on copyright, trademark and patent enforcement, contractual restrictions and trade secret and other laws to protect our brand, intellectual property and other proprietary rights. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with certain parties with whom we conduct business to limit access to and disclosure and distribution of our proprietary information. Additionally, we have applied for patents to protect certain of our intellectual property. We have registered several marks and filed other trademark applications in the United States. We have not applied for copyright protection in any jurisdiction including in the United States. However, if we are unable to adequately protect our intellectual property, it may be possible for a third party to copy or otherwise obtain and use our intellectual property without authorization, and our business may suffer from the piracy of our technology and the associated loss in revenue.

Protecting against the unauthorized use of our intellectual property and other proprietary rights is expensive, difficult and, in some cases, impossible. The steps we take may not prevent misappropriation or infringement of our intellectual property or other proprietary rights. Litigation may be necessary in the future to enforce or defend our intellectual property or other proprietary rights, to protect our intellectual property or to determine the validity and scope of the intellectual property or other proprietary rights of others. Such litigation could be costly and divert management resources, either of which could harm our business. Furthermore, many of our current and potential

competitors have the ability to dedicate substantially greater resources to enforce their intellectual property and other proprietary rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property or other proprietary rights.

We are not currently involved in any legal proceedings with respect to protecting our intellectual property or other proprietary rights; however, we may from time to time become a party to various legal proceedings with respect to protecting our intellectual property or other proprietary rights arising in the ordinary course of our business.

Any claims from a third party that we are infringing upon its intellectual property, whether valid or not, could subject us to costly and time-consuming litigation or expensive licenses or force us to curtail some services or products.

Companies in the internet and technology industries tend to own large numbers of patents, copyrights, trademarks and trade secrets, and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. We have been subject to claims that the presentation of certain licensed content on our Managed Portals infringes certain patents of a third party, none of which have resulted in material direct settlement or payments by us or any determination of infringement by us, and as we face increasing competition, the possibility of further intellectual property rights claims against us grows. Our technologies may not be able to withstand any third party claims or rights against their use. Any intellectual property claims, with or without merit, could be time-consuming, expensive to litigate or settle and could divert management resources and attention. An adverse determination also could prevent us from offering our services and products to others and may require that we procure substitute products or services for our customers.

In the case of any intellectual property rights claim, we may have to pay damages or stop using technology found to be in violation of a third party's rights. We may have to seek a license for the technology, which may not be available to us on reasonable terms and may significantly increase our operating expenses. The technology also may not be available for license to us at all. As a result, we may also be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for the infringing aspects of our business, we may be forced to limit our service and product offerings and may be unable to compete effectively. Any of these consequences could harm our operating results.

In addition, we typically have contractual obligations to our customers to indemnify and defend them with respect to third-party intellectual property infringement claims that arise from our customers' use of our products or services. Such claims, whether valid or not, could harm our relationships with our customers, have resulted and could result in the future in us or our customers having to enter into licenses with the claimants and have caused and could cause us in the future to incur additional costs or experience reduced revenue. To date, neither the increase in our costs nor any reductions in our revenue resulting from such claims have been material. Such claims could also subject us to costly and time-consuming litigation as well as diverting management attention and resources. Satisfying our contractual indemnification obligations could also give rise to significant liability, and thus harm our business and our operating results.

We are not currently subject to any material legal proceedings with respect to third party claims that we or our customers' use of our products and services are infringing upon their intellectual property; however, we may from time to time become a party to various legal proceedings with respect to such claims arising in the ordinary course of our business.

Any unauthorized disclosure or theft of personal information we gather could harm our reputation and subject us to claims or litigation.

We collect, and have access to, personal information of subscribers, including names, addresses, account numbers, credit card numbers and email addresses. Unauthorized disclosure of such personal information, whether through breach of our systems by an unauthorized party, employee theft or misuse, or otherwise, could harm our business. If there were an inadvertent disclosure of personal information, or if a third party were to gain unauthorized access to the personal information we possess, our operations could be seriously disrupted and we could be subject to claims or litigation arising from damages suffered by subscribers or our customers. In addition, we could incur significant costs in complying with the multitude of state, federal and foreign laws regarding the unauthorized disclosure of personal information. Finally, any perceived or actual unauthorized disclosure of the information we collect could harm our reputation, substantially impair our ability to attract and retain customers and have an adverse impact on our business.

We collect and may access personal information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, and our actual or perceived failure to comply with such obligations could harm our business.

We collect, and have access to, personal information of subscribers, including names, addresses, account numbers, credit card numbers and email addresses. There are numerous federal, state and local laws, rules and guidelines around the world regarding privacy and the collection, storing, sharing, use, processing, disclosure, destruction and security of personal information and other subscriber data, the scope of which are changing, subject to differing interpretations, and may be inconsistent between countries or conflict with other rules. For example, the EU General Data Protection Regulation, or the Regulation, came into effect in May 2018. The Regulation replaced the existing 1995 European Union Data Protection Directive, or the Directive, and introduced new and onerous data protection requirements for companies processing data of European citizens, as well as substantial fines for breaches of the data protection rules. In 2016, to facilitate compliance with the Directive, the European Commission and the United States Department of Commerce designed a program known as the EU-US Privacy Shield, or the Privacy Shield, which provides a mechanism for U.S. companies to comply with data protection requirements under the Directive when transferring personal information from the European Economic Area, or the EEA, to the United States. The Privacy Shield includes more stringent operational and legal requirements for parties processing EEA personal information and imposes significant penalties for

non-compliance. Similarly, in early 2017, the Swiss Federal Data Protection and Information Commissioner and the United States Department of Commerce designed a program known as the Swiss-U.S. Privacy Shield, which provides a mechanism for U.S. companies to comply with Swiss data protection requirements when transferring personal information from Switzerland to the United States. We certified compliance with the EU-US Privacy Shield and the Swiss-U.S. Privacy Shield to the United States Department of Commerce in December 2016 and June 2017, respectively. Compliance with the EU-US Privacy Shield and Swiss-U.S. Privacy Shield are not, alone, sufficient to comply with the obligations contained in the Directive or the Regulation.

We strive to comply with all applicable laws, policies, legal obligations and industry codes of conduct relating to privacy and data protection to the extent possible. However, we may fail to comply with such laws, rules and guidelines, and it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us to comply with our privacy policies, our privacy-related obligations to users or other third parties, or our privacy-related legal obligations (including obligations in agreements with our customers), or any compromise of security that results in the unauthorized release or transfer of personal information or other subscriber data, may result in governmental enforcement actions, significant fines, loss of access to data transfer mechanisms, litigation or public statements against us by consumer advocacy groups or others and could cause our customers to lose trust in us, or, in some situations, terminate their agreements with us, all of which could have an adverse effect on our business. Additionally, if third parties we work with, such as customers, vendors or developers, violate applicable laws or our policies, such violations may also put subscriber information at risk and could in turn have an adverse effect on our business.

Any failure to convince advertisers of the benefits of advertising with us would harm our business, financial condition and results of operations.

We have derived and expect to continue to derive a substantial portion of our revenue from digital advertising, including advertising on our Managed Portals. Such advertising accounted for approximately 45%, 46%, and 43% of our revenue for the years ended December 31, 2017, 2016, and 2015, respectively, and approximately 45% and 45% of our revenue for the three and six months ended June 30, 2018. Our ability to attract and retain advertisers and, ultimately, to generate advertising revenue depends on a number of factors, including:

- increasing the numbers of consumers using our Managed Portals;
- maintaining consumer engagement on those Managed Portals;
- competing effectively for advertising spending with other online and offline advertising providers.

If we are unable to provide high-quality advertising opportunities and convince advertisers and agencies of our value proposition, we may not be able to retain existing advertisers or attract new ones, which would harm our business, financial condition and results of operations.

Migration of high-speed internet service providers' consumers from one high-speed internet service provider to another could adversely affect our business, financial condition and results of operations.

Consumers may become dissatisfied with their current high-speed internet service provider and may switch to another provider. In the event that there is substantial subscriber migration from our existing customers to service providers with which we do not have relationships, the fees that we receive on a per-subscriber basis, and the related revenue, including search and digital advertising revenue, could decline.

If we are unable to implement and maintain effective internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be adversely affected.

As a public company, we are required to maintain internal control over financial reporting and to disclose any material weaknesses in such internal control. A material weakness is defined as a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our financial statements will not be prevented or detected on a timely basis. Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires that we evaluate and determine the effectiveness of our internal control over financial reporting and provide a management report on internal control over financial reporting. The Sarbanes-Oxley Act also requires that our management report on internal control over financial reporting be attested to by our independent registered public accounting firm.

During our assessment of internal control over financial reporting as of December 31, 2017, we identified three material weaknesses in our internal control over financial reporting: (i) an ineffective control environment due to a lack of sufficient qualified accounting personnel with an appropriate level of knowledge and experience, (ii) ineffective control activities due to the lack of timeliness in executing business process controls, and (iii) ineffective monitoring controls to ascertain whether the components of internal control were present and functioning. We are working to remediate these material weaknesses. For more information about these material weaknesses and our remediation efforts, see Part I, Item 4 of this Quarterly Report on Form 10-Q and Part II, Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2017. Although we plan to complete this remediation process as quickly as possible, we cannot at this time estimate how long it will take, and our efforts may not be successful in remediating these material weaknesses. As part of the remediation process, we may incur additional costs in improving our internal control over financial reporting.

Many of the internal controls we have implemented pursuant to the Sarbanes-Oxley Act are process controls with respect to which a material weakness may be found whether or not any error has been identified in our reported financial statements. This may be confusing to investors and result in damage to our reputation, which may harm our business. Additionally, the proper design and assessment of internal controls over financial reporting are subject to varying interpretations, and as a result, application in practice may evolve over time as new guidance is provided by regulatory and governing bodies and as common practices evolve. This could result in continuing uncertainty regarding the proper design and assessment of internal controls over financial reporting and higher costs necessitated by ongoing revisions to internal controls.

We must continue to monitor and assess our internal control over financial reporting. If we are unable to successfully remediate these material weaknesses or if we identify additional material weaknesses, we may not detect errors on a timely basis and our financial statements may be materially misstated. This could harm our operating results, cause us to fail to meet our SEC reporting obligations or Nasdaq listing requirements on a timely basis, adversely affect our reputation, cause our stock price to decline or result in inaccurate financial reporting or material misstatements in our annual or interim financial statements.

Notwithstanding the material weaknesses identified during our assessment, (i) we have concluded, and our auditors have expressed an unqualified opinion, that the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 presented fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented, and (ii) we have concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented.

Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited as a result of future transactions in our stock which may be outside our control.

As of June 30, 2018, we had substantial federal and state net operating loss carryforwards. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Code, if a corporation undergoes an “ownership change,” the corporation’s ability to use its pre-change net operating loss carryforwards to offset its post-change income and taxes may be limited. In general, an “ownership change” generally occurs if there is a cumulative change in our ownership by “five-percent stockholders” that exceeds 50 percentage points over a rolling three-year period. For these purposes, a five-percent stockholder is generally any person or group of persons that at any time during the applicable testing period has owned 5% or more of our outstanding stock. In addition, persons who own less than 5% of the outstanding stock are grouped together as one or more “public groups,” which are also treated as five-percent stockholders. Similar rules may apply under state tax laws. We may experience ownership changes in the future as a result of future transactions in our stock, some of which may be outside our control. As a result, our ability to use our pre-change net operating loss carryforwards to offset United States federal and state taxable income and taxes may be

subject to limitations.

We have been named as a party to a lawsuit and we may be named in additional litigation or legal proceedings in the future.

We have been named as a party in a lawsuit described under “Part II—Item 1—Legal Proceedings” and we may be named in additional litigation or other legal proceedings in the future, all of which could result in an unfavorable outcome and have an adverse effect on our business, financial condition, results of operations, cash flows, and the trading price for our securities. Under certain circumstances, we have contractual and other legal obligations to indemnify and to incur legal expenses on behalf of current and former directors and officers in connection with the litigation described in Part II—Item 1 and in connection with any future lawsuits. The ultimate outcome of the litigation described in Part II—Item 1, and any other litigation or legal proceedings, may have an adverse effect on our business and the trading price for our securities. Litigation and other legal proceedings may be time-consuming, expensive, and disruptive to normal business operations, and the outcome of such matters is difficult to predict. The defense of the litigation described in Part II—Item 1, and any other lawsuits or legal proceedings, may result in significant expenditures and the continued diversion of our management’s time and attention from the operation of our business, which could impede our business. In the event we were to receive an unfavorable or unexpected outcome in any lawsuit or other legal proceeding, our business, financial condition, results of operations, cash flows and the trading price of our securities may be adversely affected.

Risks Related to Our Industry

The growth of the market for our services and products depends on the continued growth of the internet as a medium for content, advertising, commerce and communications.

Expansion in the sales of our services and products depends on the continued acceptance of the internet as a platform for content, advertising, commerce and communications. The acceptance of the internet as a medium for such uses could be adversely impacted by delays in the development or adoption of new standards and protocols to handle increased demands of internet activity, security, privacy protection, reliability, cost, ease of use, accessibility and quality of service. The performance of the internet and its acceptance as such a medium has been harmed by viruses, worms, and similar malicious programs, and the internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure. If for any reason the internet does not remain a medium for widespread content, advertising, commerce and communications, the demand for our services and products would be significantly reduced, which would harm our business.

The growth of the market for our services and products depends on the development and maintenance of the internet infrastructure.

Our business strategy depends on continued internet and high-speed internet access growth. Any downturn in the use or growth rate of the internet or high-speed internet access would be detrimental to our business. If the internet continues to experience significant growth in number of users, frequency of use and amount of data transmitted, the internet infrastructure might not be able to support the demands placed on it and the performance or reliability of the internet may be adversely affected. The success of our business therefore depends on the development and maintenance of a sound internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products, such as routers, for providing reliable internet access and services. Consequently, as internet usage increases, the growth of the market for our products depends upon improvements made to the internet as well as to individual customers' networking infrastructures to alleviate overloading and congestion. In addition, any delays in the adoption of new standards and protocols required to govern increased levels of internet activity or increased governmental regulation may have a detrimental effect on the internet infrastructure.

A majority of our revenue is derived from our Managed Portals and Advertising solutions; our revenue would decline if advertisers do not continue their usage of the internet as an advertising medium.

We have derived and expect to continue to derive a majority of our revenue from search and digital advertising, including advertising on our Managed Portals. Such search and digital advertising revenue accounted for approximately 60%, 59% and 71% of our revenue for the years ended December 31, 2017, 2016 and 2015, or \$83.6 million, \$74.9 million, and \$78.3 million respectively, and approximately 58% and 59% for the three and six months ended June 30, 2018, or \$20.9 and \$40.8 million, respectively. However, the prospects for continued demand and market acceptance for internet advertising are uncertain. If advertisers do not continue to increase their usage of the internet as an advertising medium, our revenue would decline. Advertisers that have traditionally relied on other advertising media may not advertise on the internet. As the internet evolves, advertisers may find online advertising to be a less attractive or less effective means of promoting their services and products than traditional methods of advertising and may not continue to allocate funds for internet advertising. Many historical predictions by industry analysts and others concerning the growth of the internet as a commercial medium have overstated the growth of the internet and you should not rely upon them. This growth may not occur or may occur more slowly than estimated.

Most of our search revenue is based on the number of paid "clicks" on sponsored links that are included in search results generated from our Managed Portals. Generally, each time a consumer clicks on a sponsored link, the search provider

that provided the commercial search result receives a fee from the advertiser who paid for such sponsored link and the search provider pays us a portion of that fee. We, in turn, typically share a portion of the fee we receive with our customer. If an advertiser receives what it perceives to be a large number of clicks for which it needs to pay, but that do not result in a desired activity or an increase in sales, the advertiser may reduce or eliminate its advertisements through the search provider that provided the commercial search result to us. This reaction would lead to a loss of revenue to our search providers and consequently to lesser fees paid to us, which would have a negative effect on our financial results.

Market prices for online advertising may decrease due to competitive or other factors. In addition, if a large number of internet users use filtering software that limits or removes advertising from the users' view, advertisers may perceive that internet advertising is not effective and may choose not to advertise on the internet.

The market for internet-based services and products in which we operate is highly competitive, and if we cannot compete effectively, our sales may decline and our business may be harmed.

Competition in the market for internet-based services and products in which we operate is intense and involves rapidly changing technologies and customer and subscriber requirements, as well as evolving industry standards and frequent product introductions. Our competitors may develop solutions that are similar or superior to our technology. Our primary competitors include high-speed internet service providers with internal information technology staff capable of developing solutions similar to our technology. Other competitors include: Google; Oath, a division of Verizon; and MSN, a division of Microsoft. Advantages some of our existing and potential competitors hold over us include the following:

- significantly greater revenue and financial resources;
- stronger brand and consumer recognition;
- the capacity to leverage their marketing expenditures across a broader portfolio of services and products;
- ability to offer their products at significantly lower prices or at no cost;
- more extensive proprietary intellectual property from which they can develop or aggregate content without having to pay fees or paying significantly lower fees than we do;
- pre-existing relationships with content providers that afford them access to content while blocking the access of competitors to that same content;
- pre-existing relationships with high-speed internet service providers that afford them the opportunity to convert such providers to competing services and products;
- lower labor and development costs; and
- broader global distribution and presence.

If we are unable to compete effectively or we are not as successful as our competitors in our target markets, our sales could decline, our margins could decline and we could lose market share, any of which would harm our business, financial condition and results of operations.

Government regulation of the internet continues to evolve, and new laws and regulations could significantly harm our financial performance.

We are subject to a variety of laws, rules, guidelines and regulations in the United States and other countries governing the internet, which are frequently evolving and developing. The scope and interpretation of the laws, rules, guidelines and regulations that are or may be applicable to us are often uncertain and may be conflicting. It is difficult to predict how existing laws rules, guidelines and regulations will be applied to our business, as it exists today and may exist in the future, and the new laws rules, guidelines and regulations to which we may become subject, and changes related to such laws, rules, guidelines and regulations may adversely affect our business, financial conditions, or operations.

Over time, we expect state, federal and international legislative bodies to continue to enact more stringent laws and regulations relating to the internet. The adoption or modification of laws related to the internet could harm our business, financial condition and results of operations by, among other things, increasing our costs and administrative burdens. Due to the increasing popularity and use of the internet, many laws and regulations relating to the internet are being debated at the international, federal and state levels, which are likely to address a variety of issues such as:

- user privacy and expression;
 - ability to collect and/or share necessary information that allows us to conduct business on the internet;
- export compliance;
- pricing and taxation;

fraud;
advertising;
intellectual property rights;
consumer protection;
protection of minors;

40

content regulation;
information security; and
quality of services and products.

Several federal laws that could have an impact on our business have been adopted. For example, the Digital Millennium Copyright Act of 1998 reduces the liability of online service providers of third-party content, including content that may infringe copyrights or rights of others, but requires strict compliance with certain provisions to qualify for the safe harbor provisions; the Children's Online Privacy Protection Act imposes additional restrictions on the ability of online services to collect user information from minors under the age of 13; and the Protection of Children from Sexual Predators Act requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances.

It could be costly for us to comply with existing and potential laws and regulations, and they could harm our marketing efforts and our attractiveness to advertisers by, among other things, restricting our ability to collect demographic and personal information from consumers or to use or disclose that information in certain ways. If we were to violate these laws or regulations, or if it were alleged that we had, we could face private lawsuits, fines, penalties and injunctions and our business could be harmed.

Finally, the applicability to the internet and other online services of existing laws in various jurisdictions governing issues such as property ownership, sales and other taxes, libel and personal privacy is uncertain. Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the internet and other online services could also increase our costs of doing business, discourage internet communications, reduce demand for our services and expose us to substantial liability.

Increased regulation and industry standards related to internet privacy issues may prevent us from providing our current products and solutions to our customers, thereby harming our business.

There are numerous federal, state and local laws, rules, regulations and guidelines, and laws, rules, regulations and guidelines around the world, regarding privacy and the collection, storing, sharing, use, processing, disclosure, destruction and security of personal information and other subscriber data, the scope of which are changing, subject to differing interpretations, and may be inconsistent between countries or conflict with other laws, rules, regulations and guidelines. The regulatory framework for privacy issues worldwide is currently in flux and is likely to remain so for the foreseeable future. Practices regarding the collection, use, storage, sharing, processing, disclosure, destruction and security of personal information by companies operating over the internet have come under increased public scrutiny and, as a result, there are an increasing number of regulations and industry standards that affect our business. Regulators, including the Federal Trade Commission and regulators in the EEA, have restricted and continue to restrict our ability to use personal information and therefore may limit or inhibit our ability to operate our business. In addition, many nations and economic regions have privacy protections that are more stringent or otherwise at odds with those in the United States. For example, the EEA traditionally has imposed stricter obligations and provided for more onerous penalties than the United States. The new EU General Data Protection Regulation, or the Regulation, entered into force in May 2018. The Regulation introduced new data protection requirements in the EEA, as well as substantial fines for breaches of the data protection rules. Complying with new privacy and security requirements, whether imposed by regulation, contract or industry standard, will require additional expenditures and may result in a greater compliance burden for companies with employees or users in the EEA. Furthermore, compliance with the EU-U.S. Privacy Shield and Swiss-U.S. Privacy Shield are not, alone, sufficient to comply with the obligations contained in the Regulation, so in addition to the stringent operational and legal requirements imposed by the EU-U.S. Privacy Shield and the Swiss-U.S. Privacy Shield, we may incur additional expenses to comply with privacy and security standards and protocols imposed by the Regulation, which may have an adverse effect on our business. Furthermore, the Privacy Shield framework is facing challenges to its validity, and these challenges are expected to

continue, with the possible result being the invalidation of the Privacy Shield framework as a mechanism for legitimizing transfers of personal data from the EEA and Switzerland to the U.S. If the Privacy Shield is invalidated, we may not have a legal basis for our transfer of personal data from the EEA or Switzerland, which could constitute a violation of applicable data privacy laws and subject us to fines, third party claims, and other costs and expenses. We could also incur additional costs and expenses, and may have to divert resources, in connection with implementing an alternative basis for such transfers. Each of these scenarios could lead to an adverse impact on our business.

We may incur expenses to comply with privacy and security standards and protocols imposed by law, regulation, industry standards or contractual obligations, including without limitation due to laws such as the Regulation, CAN-SPAM Act of 2003 or other user privacy or security laws. Our non-compliance with such laws could result in governmental enforcement actions, significant fines, loss of access to data transfer mechanisms or litigation, restrict our and our customers' ability to market products to their consumers, create uncertainty in internet usage and reduce the demand for our services and products or require us to make changes to our data and security practices and our services and products, including Managed Portals. Our business, including our ability to operate and expand internationally, could be adversely affected if legislation or regulations are adopted, interpreted or implemented in

a manner that is inconsistent with our current business practices and that require changes to these practices, our services or our privacy policies.

Risks Related to Ownership of Our Common Stock

Concentration of ownership among our directors and officers and their respective affiliates could limit our other stockholders' ability to influence the outcome of key corporate decisions, such as an acquisition of our company.

Our directors and executive officers and their respective affiliates, beneficially own or directly or indirectly control (including by voting proxy), as of August 3, 2018, approximately 18% of our outstanding common stock (including exercisable options). These stockholders, if they were to act together, would have the ability to influence significantly the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, if they act together, would have the ability to influence significantly the management and affairs of our company. Accordingly, this concentration of ownership might harm the trading price of our common stock by:

- delaying, deferring or preventing a change in our control;
 - impeding a merger, consolidation, takeover or other business combination involving us;
 - preventing the election of directors who are nominated by our stockholders; or
 - discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of us.
- Our business could be negatively affected as a result of actions of stockholders or others.

In June and July 2014, entities associated with JEC Capital Partners and Ratio Capital Partners indicated, through filings with the Securities and Exchange Commission, that they each beneficially owned 4.9% of our outstanding shares of common stock. There can be no assurance that JEC Capital Partners, Ratio Capital Partners or another third party will not make an unsolicited takeover proposal in the future or take other action to acquire control of us or to otherwise influence our management and policies. Considering and responding to any future proposal is likely to result in significant additional costs to us, and future acquisition proposals, other stockholder actions to acquire control and the litigation that often accompanies them, if any, are likely to be costly and time-consuming and may disrupt our operations and divert the attention of management and our employees from executing our strategic plan.

Additionally, perceived uncertainties as to our future direction as a result of stockholder activism or actual or potential changes to the composition of our board of directors, may lead to the perception of a change in the direction of our business or other instability, which may be exploited by our competitors, cause concern to our current or potential customers, and make it more difficult to attract and retain qualified personnel. If customers choose to delay, defer or reduce their reliance on, the services we provide or do business with our competitors instead of us because of any such issues, then our business, operating results and financial condition would be adversely affected.

Future sales of our common stock may cause the trading price of our common stock to decline.

Certain of our stockholders who held shares of our preferred stock before the consummation of our public offering (and who now hold shares of our common stock) may be able to sell these shares in the public market without registration under Rule 144.

In addition, the shares that are either subject to outstanding options or warrants or that may be granted in the future under our equity plans will become eligible for sale in the public market to the extent permitted by the provisions of various vesting agreements.

If a substantial number of any of these additional shares described are sold, or if it is perceived that a substantial number of such shares will be sold, in the public market, the trading price of our common stock could decline.

Some provisions of our certificate of incorporation, bylaws and Delaware law may discourage, delay or prevent a merger or acquisition or prevent the removal of our current board of directors and management.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may discourage, delay or prevent a merger or acquisition or prevent the removal of our current board of directors and management. We have a number of anti-takeover devices in place that will hinder takeover attempts, including:

- our board of directors is classified into three classes of directors with staggered three-year terms;
- our directors may only be removed for cause, and only with the affirmative vote of a majority of the voting interest of stockholders entitled to vote;
- only our board of directors and not our stockholders will be able to fill vacancies on our board of directors;
- only our chairman of the board, our chief executive officer or a majority of our board of directors, and not our stockholders, are authorized to call a special meeting of stockholders;
- our stockholders will be able to take action only at a meeting of stockholders and not by written consent;
- our amended and restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders.

These provisions and other provisions in our charter documents could discourage, delay or prevent a transaction involving a change in our control. Any delay or prevention of a change in control transaction could cause stockholders to lose a substantial premium over the then-current trading price of their shares. These provisions could also discourage proxy contests and could make it more difficult for our stockholders to elect directors of their choosing or to cause us to take other corporate actions such stockholders desire.

In addition, we are subject to Section 203 of the Delaware General Corporation Law, which, subject to some exceptions, prohibits “business combinations” between a Delaware corporation and an “interested stockholder,” which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation’s voting stock, for a three-year period following the date that the stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

We have not paid cash dividends on our capital stock, and we do not expect to do so in the foreseeable future.

We have not historically paid cash dividends on our capital stock, and we have agreed not to pay any dividends or make any other distributions in our loan agreement with Silicon Valley Bank. We anticipate that we will retain all future earnings and cash resources for the future operation and development of our business, and as a result, we do not anticipate paying any cash dividends to holders of our capital stock for the foreseeable future. Any future determination regarding the payment of any dividends will be made at the discretion of our board of directors and will depend on our financial condition, results of operations, capital requirements, general business conditions, bank covenants and other factors that our board may deem relevant. Consequently, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment.

The trading price and volume of our common stock has been and will likely continue to be volatile, and the value of an investment in our common stock may decline.

The trading price of our common stock has been, and is likely to continue to be, volatile and could decline substantially within a short period of time. For example, since shares of our common stock were sold in our initial public offering in February 2012 at a price of \$5.00 per share through the close of business on August 3, 2018, our

trading price has ranged from \$1.03 to \$18.00. The trading price of our common stock may be subject to wide fluctuations in response to various factors, some of which are beyond our control, including but not limited to the various factors set forth in this “Risk Factors” section, as well as:

- variations in our financial performance;
- announcements of technological innovations, new services and products, strategic alliances, asset acquisitions, or significant agreements by us or by our competitors;
- changes in the estimates of our operating results or changes in recommendations or withdrawal of research coverage by securities analysts;

43

market conditions in our industry, the industries of our customers and the economy as a whole; and adoption or modification of laws, regulations, policies, procedures or programs applicable to our business or announcements relating to these matters.

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. Some companies that have had volatile market prices for their securities have had securities class actions filed against them. For example, we are presently the target of the securities litigation described under “Legal Proceedings.” Securities litigation, regardless of its merits or outcome, could cause us to incur substantial costs and could divert management’s attention. This could adversely affect our business, results of operations and financial condition.

If securities or industry analysts do not publish research or reports about our company, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our stock or publish inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

The requirements of being a public company, including increased costs and demands upon management as a result of complying with federal securities laws and regulations applicable to public companies, may adversely affect our financial performance and our ability to attract and retain directors.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, and the rules and regulations of The Nasdaq Global Market. The Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC and Nasdaq, impose additional requirements on public companies, including enhanced corporate governance practices. For example, the Nasdaq listing requirements require that listed companies satisfy certain corporate governance requirements relating to independent directors, audit committees, distribution of annual and interim reports, stockholder meetings, stockholder approvals, solicitation of proxies, conflicts of interest, stockholder voting rights and codes of business conduct. Our management team has limited experience managing a publicly-traded company or complying with the increasingly complex laws pertaining to public companies. In addition, most of our current directors have limited experience serving on the boards of public companies.

The requirements of these rules and regulations have increased and will continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming and costly and may also place undue strain on our personnel, systems and resources. Our management and other personnel must devote a substantial amount of time to these requirements. In particular, we have incurred and expect to continue to incur significant expenses and devote substantial management effort toward ensuring compliance with the requirements of Section 404 of the Sarbanes-Oxley Act, including remediating the material weaknesses described in Part I, Item 4 of this Quarterly Report on Form 10-Q and Part II, Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2017. For example, we have reassigned personnel from our finance department’s financial planning and analysis function to our accounting function, and we have engaged an outside accounting firm to provide us with the services of additional accounting support personnel.

Moreover, the rules and regulations applicable to public companies also make it more difficult and more expensive for us to maintain directors' and officers' liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate directors' and officers' insurance, our ability to recruit and retain qualified directors, especially those directors who may be considered independent for purposes of Nasdaq rules, and officers may be significantly curtailed.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

45

EXHIBIT INDEX

Exhibit No.	Exhibit
10.1	<u>Google Services Agreement between Synacor, Inc. and Google Inc., effective as of June 1, 2018.</u>
10.2	<u>Amendment #1 to Second Amended and Restated Master Services Agreement between Synacor, Inc. and Qwest Corporation, effective as of March 1, 2018.</u>
10.3.1	<u>Letter Agreement dated October 25, 2012 with Steven Davi.</u>
10.3.2	<u>Severance Agreement dated October 29, 2012 with Steven Davi.</u>
10.3.3	<u>Letter Agreement dated April 26, 2018 with Steven Davi.</u>
31.1	<u>Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2	<u>Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1	<u>Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Labels Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

Notes:

* Confidential treatment has been requested for portions of this document. The omitted portions have been filed with the Securities and Exchange Commission.

46

SIGNATURES

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

SYNACOR, INC.
(Registrant)

Date: August 9, 2018 By: /s/ Himesh Bhise
Himesh Bhise
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 9, 2018 By: /s/ Timothy J. Heasley
Timothy J. Heasley
Chief Financial Officer and Secretary
(Principal Financial and Accounting Officer)