

Upland Software, Inc.
Form 10-Q
November 14, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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 001-36720

UPLAND SOFTWARE, INC.
(Exact name of registrant as specified in its charter)

State of Delaware 27-2992077
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

401 Congress Avenue, Suite 1850 78701
Austin, Texas
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (512) 960-1010

Not Applicable
(Former name, former address, and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer Accelerated filer

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Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at November 1, 2016
Common Stock, \$0.0001 par value	17,841,355

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Item 1. Financial Statements

Upland Software, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except for share and per share information)

	September 30, 2016 (unaudited)	December 31, 2015 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 17,480	\$18,473
Accounts receivable (net of allowance of \$811 and \$581 at September 30, 2016 and December 31, 2015, respectively)	14,679	13,972
Prepaid and other	2,282	2,603
Total current assets	34,441	35,048
Canadian tax credits receivable	1,751	2,018
Property and equipment, net	5,588	6,001
Intangible assets, net	31,217	31,526
Goodwill	68,441	47,422
Other assets	440	399
Total assets	\$ 141,878	\$122,414
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 2,598	\$2,548
Accrued compensation	2,165	2,441
Accrued expenses and other	4,571	5,173
Deferred revenue	23,134	19,931
Due to sellers	5,728	2,409
Current maturities of notes payable (includes unamortized discount of \$265 and \$250 at September 30, 2016 and December 31, 2015, respectively)	1,490	1,500
Total current liabilities	39,686	34,002
Canadian tax credit liability to sellers	405	368
Notes payable, less current maturities (includes unamortized discount of \$625 and \$758 at September 30, 2016 and December 31, 2015, respectively)	35,937	22,366
Deferred revenue	139	8
Noncurrent deferred tax liability, net	3,189	2,818
Other long-term liabilities	2,416	2,582
Total liabilities	81,772	62,144
Stockholders' equity:		
Common stock, \$0.0001 par value; 50,000,000 shares authorized: 17,839,507 and 15,746,288 shares issued and outstanding as of September 30, 2016 and December 31, 2015 respectively	2	2
Additional paid-in capital	123,409	112,447
Accumulated other comprehensive loss	(2,875	) (3,289)
Accumulated deficit	(60,430	) (48,890)
Total stockholders' equity	60,106	60,270
Total liabilities and stockholders' equity	\$ 141,878	\$122,414

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

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Upland Software, Inc.
 Condensed Consolidated Statements of Operations
 (In thousands, except for share and per share information)
 (unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Revenue:				
Subscription and support	\$17,029	\$ 14,129	\$48,490	\$ 42,474
Perpetual license	332	540	1,108	2,197
Total product revenue	17,361	14,669	49,598	44,671
Professional services	1,880	2,436	5,795	7,640
Total revenue	19,241	17,105	55,393	52,311
Cost of revenue:				
Subscription and support	5,747	4,771	16,607	14,344
Professional services	1,045	1,677	3,775	5,317
Total cost of revenue	6,792	6,448	20,382	19,661
Gross profit	12,449	10,657	35,011	32,650
Operating expenses:				
Sales and marketing	3,097	2,929	9,119	9,907
Research and development	3,737	3,852	11,701	11,930
Refundable Canadian tax credits	(115)	(115)	(340)	(358)
General and administrative	4,670	4,494	13,340	14,327
Depreciation and amortization	1,322	1,130	4,270	3,207
Acquisition-related expenses	1,047	176	4,855	1,081
Total operating expenses	13,758	12,466	42,945	40,094
Loss from operations	(1,309)	(1,809)	(7,934)	(7,444)
Other expense:				
Interest expense, net	(709)	(462)	(1,932)	(1,385)
Other expense, net	(64)	137	(1,105)	(387)
Total other expense	(773)	(325)	(3,037)	(1,772)
Loss before provision for income taxes	(2,082)	(2,134)	(10,971)	(9,216)
Provision for income taxes	(308)	(190)	(569)	(185)
Net loss	\$(2,390)	\$(2,324)	\$(11,540)	\$(9,401)
Net loss per common share:				
Net loss per common share, basic and diluted	\$(0.14)	\$(0.16)	\$(0.71)	\$(0.63)
Weighted-average common shares outstanding, basic and diluted	16,702,062	14,934,796	16,339,983	14,882,893
The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.				

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Upland Software, Inc.
 Condensed Consolidated Statements of Comprehensive Loss
 (In thousands)
 (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	\$(2,390)	\$(2,324)	\$(11,540)	\$(9,401)
Foreign currency translation adjustment	(67)	(757)	414	(1,245)
Comprehensive loss	\$(2,457)	\$(3,081)	\$(11,126)	\$(10,646)

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

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Upland Software, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Nine Months Ended September 30,	
	2016	2015
Operating activities		
Net loss	\$(11,540)	\$(9,401)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,499	6,077
Deferred income taxes	251	450
Foreign currency re-measurement (gain) loss	(222)	) 779
Non-cash interest and other expense	196	312
Non-cash stock compensation expense	2,664	1,990
Loss on disposal of business	686	—
Changes in operating assets and liabilities, net of purchase business combinations:		
Accounts receivable	310	3,689
Prepays and other	820	1,097
Accounts payable	(126)	) 40
Accrued expenses and other liabilities	(828)	) (2,069)
Deferred revenue	1,425	(1,293)
Net cash provided by operating activities	1,135	1,671
Investing activities		
Purchase of property and equipment	(886)	) (461)
Purchase of customer relationships	(408)	) (372)
Purchase business combinations, net of cash acquired	(11,846)	) (2,714)
Net cash used in investing activities	(13,140)	) (3,547)
Financing activities		
Payments on capital leases	(1,320)	) (767)
Proceeds from notes payable, net of issuance costs	14,925	24,088
Payments on notes payable	(1,560)	) (23,592)
Issuance of common stock, net of issuance costs	197	62
Additional consideration paid to sellers of businesses	(1,484)	) (9)
Net cash provided by (used in) financing activities	10,758	(218)
Effect of exchange rate fluctuations on cash	254	(200)
Change in cash and cash equivalents	(993)	) (2,294)
Cash and cash equivalents, beginning of period	18,473	30,988
Cash and cash equivalents, end of period	\$17,480	\$28,694
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$1,707	\$1,108
Cash paid for taxes	\$518	\$327
Noncash investing and financing activities:		
Equipment acquired pursuant to capital lease obligations	\$802	\$1,796
Issuance of common stock in business combination	\$8,100	\$—

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

Upland Software, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States ("GAAP"). The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. In the opinion of management of the Company, the unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments necessary for a fair presentation. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016 or for any other period. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2015 Annual Report on Form 10-K filed with the SEC on March 30, 2016.

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses. Significant items subject to such estimates include allowance for doubtful accounts, stock-based compensation, contingent consideration, acquired intangible assets, the useful lives of intangible assets and property and equipment, and income taxes. In accordance with GAAP, management bases its estimates on historical experience and on various other assumptions that management believes are reasonable under the circumstances. Management regularly evaluates its estimates and assumptions using historical experience and other factors; however, actual results could differ from those estimates.

Concentrations of Credit Risk and Significant Customers

Financial instruments that potentially subject the Company to credit risk consist of cash and cash equivalents and accounts receivable. The Company's cash and cash equivalents are placed with high-quality financial institutions, which, at times, may exceed federally insured limits. The Company has not experienced any losses in these accounts, and the Company does not believe it is exposed to any significant credit risk related to cash and cash equivalents. The Company provides credit, in the normal course of business, to a number of its customers. The Company performs periodic credit evaluations of its customers and generally does not require collateral. No individual customer represented more than 10% of total revenues in the three and nine months ended September 30, 2016 or 2015 or for the year ended December 31, 2015, or more than 10% of accounts receivable as of September 30, 2016 or December 31, 2015.

Fair Value of Financial Instruments

The Company's financial instruments consist principally of cash and cash equivalents, accounts receivable, and accounts payable, and long-term debt. The carrying value of cash and cash equivalents, accounts receivable, and accounts payable approximate fair value, primarily due to short maturities. The carrying values of the Company's debt instruments approximated their fair value based on rates currently available to the Company.

Recent Accounting Pronouncements

In May 2014, the FASB issued FASB ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. In August 2015, the FASB issued FASB ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, using one of two retrospective application methods. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently evaluating the effect that the adoption of ASU 2014-09 and ASU 2015-14 will have on its financial statements as well as timing of adoption and method of adoption.

In August 2014, the FASB issued FASB ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. The adoption of this standard is not expected to have a material impact on our financial statements. The Company does not intend to adopt this standard prior to the effective date.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. ASU 2015-17 eliminates the requirement for an entity to separate deferred income taxes and liabilities into current and noncurrent amounts in a classified statement of financial position. To simplify the presentation of deferred income taxes, the amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. As all deferred tax assets and liabilities recognized in the balance sheet as of December 31, 2015 were noncurrent, the early adoption of this guidance in the first quarter of 2016, using retrospective application, does not result in any reclassification as of December 31, 2015.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The core change with ASU 2016-02 is the requirement for the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the effect that the adoption of ASU 2016-02 will have on its financial statements.

In March 2016, the FASB issued ASU 2016-09, Stock Compensation (Topic 718). The core change with ASU 2016-09 is the simplification of several aspects of the accounting for share-based payment transactions, including the income tax consequences, classifications of awards as either equity or liabilities, and classification on the statement of cash flows. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. The Company is currently evaluating the effect that the adoption of ASU 2016-09 will have on its financial statements.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing. The amendments in ASU 2016-10 do not change the core principle of the guidance in Topic 606. Rather, the amendments in ASU 2016-10 clarify the following two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related

principles for those areas. The Company is currently evaluating the effect that the adoption of ASU 2016-10 will have on its financial statements.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606) - Narrow Scope Improvements and Practical Expedients. The amendments in ASU 2016-12 do not change the core principle of the guidance in Topic 606. Rather, the amendments clarify the following aspects of Topic 606: assessing the collectibility, presentation of sales taxes, noncash consideration, contract modifications at transition, completed contracts at modification, and retrospective application, while retaining the related principles for those areas. The Company is currently evaluating the effect that the adoption of ASU 2016-12 will have on its financial statements.

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Updates (“ASU”) No. 2016-13, “Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments”, which changes the impairment model for most financial assets. The new model uses a forward-looking expected loss method, which will generally result in earlier recognition of allowances for losses. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted for annual and interim periods beginning after December 15, 2018. The Company is currently evaluating the effect that the adoption of ASU 2016-13 will have on its financial statements.

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15). ASU 2016-15 is intended to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows and to eliminate the diversity in practice related to such classifications. The guidance in ASU 2016-15 is required for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company is currently evaluating the effect that the adoption of ASU 2016-15 will have on its financial statements.

2. Acquisitions

2016 Acquisitions

On January 7, 2016, Upland completed its purchase of substantially all of the assets of our California-based website analytics provider. The purchase price consideration paid was approximately \$8.1 million in cash payable at closing (net of \$0.3 million of cash acquired) and a \$1.2 million cash holdback payable in 12 months (subject to indemnification claims). The foregoing excludes additional potential earnout payments tied to performance-based conditions. Revenues recorded since the acquisition date through September 30, 2016 were approximately \$2,365,000.

In addition to the cash consideration described above, the Asset Purchase Agreement included a contingent share consideration component pursuant to which Upland issued an aggregate of \$2.4 million in common stock on July 25, 2016. The Company agreed to additional consideration of up to \$5 million in cash to the selling shareholders of our website analytics business based on the achievement of certain revenue targets during fiscal years 2016 and 2017.

On March 14, 2016, Upland completed its purchase of substantially all of the assets of Hipcricket, Inc., a cloud-based mobile messaging software provider. The consideration paid to the seller consisted of our issuance of one million shares of our common stock and the transfer of our EPM Live product business. The value of the shares on the closing date of the transaction was approximately \$5.7 million and the fair value of our EPM Live product business was approximately \$5.9 million. The Company recognized a loss on the transfer in conjunction with the EPM Live net asset value of approximately \$0.7 million in Other expense, net. Prior to the transaction, Hipcricket was owned by an affiliate of ESW Capital, LLC, which is a shareholder of Upland. Raymond James & Co. provided a fairness opinion to Upland in connection with the transaction. Revenues recorded since the acquisition date through September 30, 2016 were approximately \$2,447,000.

On April 27, 2016, Upland acquired Advanced Processing & Imaging, Inc., a content management platform driving workflow in governments and schools. The purchase price consideration consisted of \$4.0 million in cash payable at

closing (net of \$0.2 million of cash acquired), and a \$0.8 million cash holdback payable in 12 months (subject to indemnification claims). Revenues recorded since the acquisition date through September 30, 2016 were approximately \$1,088,000.

The Company recorded the purchase of the acquisitions described above using the acquisition method of accounting and, accordingly, recognized the assets acquired and liabilities assumed at their fair values as of the date of the acquisition. The purchase price allocations for the 2015 acquisition of Ultriva and the 2016 acquisitions of our website analytics business, Hipcricket and API are preliminary as the Company has not obtained and evaluated all of the detailed information necessary to finalize the opening balance sheet amounts in all respects. Management has recorded the purchase price allocations based upon acquired company information that is currently available. Management expects to finalize its purchase price allocations in the latter half of 2016.

The following condensed table presents the preliminary acquisition-date fair value of the assets acquired and liabilities assumed for the acquisitions, as well as assets and liabilities (in thousands):

	API	HipCricket	Website Analytics Business
Year Acquired or Divested	2016	2016	2016
Cash	\$125	\$—	\$290
Accounts receivable	769	1,275	178
Other current assets	54	238	55
Property and equipment	68	—	5
Customer relationships	1,590	1,900	2,310
Trade name	40	70	70
Technology	780	900	1,390
Goodwill	3,363	7,747	12,524
Other assets	92	—	6
Total assets acquired	6,881	12,130	16,828
Accounts payable	(11)	(200)	—
Accrued expense and other	(170)	—	(178)
Deferred revenue	(1,700)	(330)	(910)
Total liabilities assumed	(1,881)	(530)	(1,088)
Total consideration	\$5,000	\$11,600	\$15,740

Tangible assets were valued at their respective carrying amounts, which approximates their estimated fair value. The valuation of identifiable intangible assets reflects management's estimates based on, among other factors, use of established valuation methods. Customer relationships were valued using an income approach, which estimates fair value based on the earnings and cash flow capacity of the subject asset. The value of the marketing-related intangibles was determined using a relief-from-royalty method, which estimates fair value based on the value the owner of the asset receives from not having to pay a royalty to use the asset. Developed technology was valued using a cost-to-recreate approach.

Goodwill deductible for tax purposes is \$4.9 million for our website analytics business acquisition and \$8.2 million for HipCricket. There was no Goodwill deductible for tax purposes for our API acquisition.

3. Fair Value Measurements

Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. GAAP sets forth a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. The three tiers are Level 1, defined as observable inputs, such as quoted market prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore, requiring an entity to develop its own assumptions.

Changes to the fair value of earnout liabilities are recorded to other expense, net. Liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	Fair Value Measurements at December 31, 2015			
	Level 1	Level 2	Level 3	Total
Earnout consideration liability	\$—	—\$ 500	\$500	
	Fair Value Measurements at September 30, 2016 (unaudited)			
	Level 1	Level 2	Level 3	Total
Earnout consideration liability	\$—	—\$3,100	\$3,100	

The earnout consideration liability consists of amounts associated with the acquisitions of Mobile Commons and our website analytics business acquisition. The fair value of the earnout consideration associated with the Mobile Commons acquisition was determined using the Binary Option model based on the present value of the probability-weighted earnout consideration. This \$0.5 million Level 3 earnout consideration liability was removed through settlement during the nine months ended September 30, 2016. The \$3.1 million addition to fair value of the earnout consideration associated with our website analytics business acquisition was determined using the Monte Carlo Simulation method based on the present value of the probability-weighted earnout consideration. The Monte Carlo Simulation method includes assumptions as to probability of various outcomes and, accordingly, the actual contingent consideration incurred could vary from the current estimate. However, the total contingent consideration incurred would not exceed the maximum potential payout of \$5.0 million in cash and \$2.4 million in common stock (which was fully issued during July, 2016). In conjunction with the contingent stock consideration, the increase in fair value issued over carrying value of \$80 thousand was recorded in Other Expense (see Note 2).

The following table presents additional information about liabilities measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value:

Beginning balance at January 1, 2016	500
Additions - stock earnouts	2,320
Additions - cash earnouts	3,100
Change in fair value - stock earnouts	80
Settlements - cash earnouts	(500)
Settlements - stock earnouts	(2,400)
Ending balance at December 31, 2016	3,100

Debt

The Company believes the carrying value of its long-term debt at September 30, 2016 approximates its fair value based on the variable interest rate feature or based upon interest rates currently available to the Company.

The estimated fair value of our debt at September 30, 2016 and December 31, 2015 is \$38.3 million and \$24.9 million, respectively, based on valuation methodologies using interest rates currently available to the Company which are Level 2 inputs.

4. Goodwill and Other Intangible Assets

Changes in the Company's goodwill balance for the nine months ended September 30, 2016 are summarized in the table below (in thousands):

Balance at December 31, 2015	\$47,422
Acquired in business combinations	23,934
Divestiture of business	(3,673)
Adjustment due to prior year business combinations	48
Foreign currency translation adjustment	710
Balance at September 30, 2016	\$68,441

Intangible assets, net, include the estimated acquisition-date fair values of customer relationships, marketing-related assets, and developed technology that the Company recorded as part of its business acquisitions.

The following is a summary of the Company's intangible assets, net (in thousands):

	Estimated Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
December 31, 2015:				
Customer relationships	1-10	\$ 31,848	\$ 9,054	\$ 22,794
Trade name	1-3	2,909	2,476	433
Developed technology	4-7	13,808	5,509	8,299
Total intangible assets		\$ 48,565	\$ 17,039	\$ 31,526
	Estimated Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
September 30, 2016:				
Customer relationships	1-10	\$ 33,990	\$ 11,749	\$ 22,241
Trade name	1.5-3	2,642	2,371	271
Developed technology	4-7	15,298	6,593	8,705
Total intangible assets		\$ 51,930	\$ 20,713	\$ 31,217

The following table summarizes the Company's weighted-average amortization period, in total and by major finite-lived intangible asset class (in years), as of:

	September 30, 2016	December 31, 2015
Customer relationships	9.3	9.3
Trade name	2.8	2.9
Developed technology	6.3	6.4
Total weighted-average amortization period	8.1	8.1

The Company periodically reviews the estimated useful lives of its identifiable intangible assets, taking into consideration any events or circumstances that might result in either a diminished fair value or revised useful life. There have been no indicators of impairment or change in the useful life during the three and nine months ended September 30, 2016 and 2015. Total amortization expense was \$5.6 million and \$4.5 million during the nine months ended September 30, 2016 and 2015, respectively.

Estimated annual amortization expense for the next five years and thereafter is as follows (in thousands):

	Amortization Expense
Year ending December 31:	
Remainder of 2016	\$ 1,620
2017	6,097
2018	5,752
2019	4,939
2020 and thereafter	12,809
Total	\$ 31,217

5. Income Taxes

The Company's income tax provision for the three and nine months ended September 30, 2016 and 2015 reflects its estimate of the effective tax rates expected to be applicable for the full years, adjusted for any discrete events that are recorded in the period in which they occur. The estimates are reevaluated each quarter based on the estimated tax expense for the full year. The tax provision for the three and nine months ended September 30, 2016 and 2015 is primarily related to foreign income taxes associated with our Canadian operations, changes in deferred tax liabilities associated with amortization of United States tax deductible goodwill and state taxes in certain states in which the Company does not file on a consolidated basis. The Company has historically incurred operating losses in the United States and, given its cumulative losses and limited history of profits, has recorded a valuation allowance against its United States net deferred tax assets, exclusive of tax deductible goodwill, at September 30, 2016 and 2015.

The Company has reflected any uncertain tax positions within its current taxes payable, but none in deferred taxes. Federal, state, and foreign income tax returns have been filed in jurisdictions with varying statutes of limitations. Varying among the separate companies, tax years 1998 through 2015 remain subject to examination by federal and most state tax authorities due to our net operating loss carryforwards. In the foreign jurisdictions, tax years 2008 through 2015 remain subject to examination.

6. Net Loss Per Share

The following table sets forth the computations of loss per share (in thousands, except share and per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Net Loss	\$(2,390)	\$(2,324)	\$(11,540)	\$(9,401)
Denominator:				
Weighted-average common shares outstanding, basic and diluted	16,702,061	14,934,796	16,339,983	14,882,893
Net loss per common share, basic and diluted	\$(0.14)	\$(0.16)	\$(0.71)	\$(0.63)

Due to the net losses for the three and nine months ended September 30, 2016 and 2015, basic and diluted loss per share were the same, as the effect of all potentially dilutive securities would have been anti-dilutive. The following table sets forth the anti-dilutive common share equivalents (which does not include 318,302 common shares issued July 25, 2016 in conjunction with the acquisition of our website analytics business, as a result of the achievement of certain revenue targets):

	September 30,	
	2016	2015
Stock options	780,645	616,705
Restricted stock	1,055,738	431,872
Total anti-dilutive common share equivalents	1,836,383	1,048,577

7. Commitments and Contingencies

Purchase Commitments

The Company has an outstanding purchase commitment for software development services pursuant to a technology services agreement in the amount of \$2.3 million in 2016, of which \$1.7 million was incurred during the nine months ended September 30, 2016. For years after 2016, the purchase commitment amount for software development services will be equal to the prior year purchase commitment increased (decreased) by the percentage change in total revenue for the prior year as compared to the preceding year. For example, if 2016 total revenues increase by 10% as compared to 2015 total revenues, then the 2017 purchase commitment would increase by approximately \$0.2 million from the 2016 purchase commitment amount to \$2.6 million. A similar 10% increase in 2017 total revenues as compared to 2016 total revenues would increase the 2018 purchase commitment amount from the theoretical 2017 purchase commitment amount of \$2.6 million by approximately \$0.3 million to \$2.9 million.

Litigation

In the normal course of business, the Company may become involved in various lawsuits and legal proceedings. While the ultimate results of these matters cannot be predicted with certainty, the Company does not expect them to have a material adverse effect on the consolidated financial position or results of operations of the Company.

8. Stockholders' Equity

Restricted Stock Awards

Restricted share activity during the nine months ended September 30, 2016 was as follows:

	Number of Restricted Shares Outstanding	Weighted-Average Grant Date Fair Value
Unvested balances at December 31, 2015	513,943	\$ 8.15
Awards granted	728,681	
Awards vested	(136,886)	
Awards forfeited	(50,000)	
Unvested balances at September 30, 2016	981,175	\$ 7.42

Stock Option Activity

Stock option activity during the nine months ended September 30, 2016 was as follows:

	Number of Options Outstanding	Weighted- Average Exercise Price
Outstanding at December 31, 2015	778,388	\$ 5.75
Options granted	137,586	\$ 7.74
Options exercised	(39,564)	\$ 4.99
Options forfeited	(60,726)	\$ 7.14
Options expired	(35,039)	\$ 4.85
Outstanding at September 30, 2016	780,645	\$ 6.06

Share-based Compensation

The Company recognized share-based compensation expense from all awards in the following expense categories (in thousands):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Cost of subscription and support revenue	\$13	\$17	\$27	\$41
Cost of professional services revenue	—	1	1	(7)
Sales and marketing	21	5	66	55
Research and development	38	69	80	189
General and administrative	1,028	563	2,490	1,712
Total	\$1,100	\$655	\$2,664	\$1,990

9. Domestic and Foreign Operations

Revenue by geography is based on the ship-to address of the customer, which is intended to approximate where the customer's users are located. The ship-to country is generally the same as the billing country. The Company has operations in the U.S., Canada and Europe. Information about these operations is presented below (in thousands):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Revenues:				
U.S.	\$16,240	\$14,271	\$46,403	\$42,530
Canada	1,058	981	3,071	3,204
Other International	1,943	1,853	5,919	6,577
Total Revenues	\$19,241	\$17,105	\$55,393	\$52,311

10. Related Party Transactions

The Company purchased software development services pursuant to a technology services agreement with a company controlled by a non-management investor in the Company during the three months ended September 30, 2016 and 2015 in the amount of \$587,000 and \$550,000 and during the nine months ended September 30, 2016 and 2015 in the amount of \$1,732,000 and \$1,425,000, respectively. Refer to Note 7 for a description of purchase commitments to this company.

When the Company receives requested services as detailed by statements of work pursuant to the software development agreement, it determines whether such software development costs should be capitalized as either internally-used software or software to be sold or otherwise marketed. If such costs are not capitalizable, the Company expenses such costs as the services are received. If the Company anticipates that it will not utilize the full amount of the annual minimum fee, the estimated unused portion of the annual minimum fee is expensed at that time.

The Company also purchased approximately \$553,000 and \$1,147,000 in services from a company controlled by a non-management investor in the Company during the three and nine months ended September 30, 2016. There are no purchase commitments with this company, and the Company continues to use their services in 2016.

The Company has an arrangement with a former subsidiary to provide management, human resource/payroll and administrative services, the fees for which during 2015 totaled \$360,000 and are expected to be similar in 2016, and these fees during the three and nine months ended September 30, 2016 and 2015 totaled \$90,000 and \$270,000, respectively, in both periods.

On March 14, 2016, Upland completed its purchase of substantially all of the assets of Hipcricket, Inc., a cloud-based mobile messaging software provider, and completed the transfer of its EPM Live product business. Prior to the transaction, Hipcricket was owned by an affiliate of ESW Capital, LLC, which is a shareholder of Upland. Raymond James & Co. provided a fairness opinion to Upland in connection with the transaction. Refer to Note 3 for a description of the transaction. Relating to this transaction, the Company is providing certain transition services to and receiving certain transition services from the affiliate. The cost offsets earned by the Company for these services during the three and nine months ended September 30, 2016 totaled \$0 and \$706,000 and the fees owed to the affiliate by the Company for these services during the three and nine months ended September 30, 2016 totaled \$0 and \$144,000, respectively.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

Forward-looking statements may be identified by the use of forward-looking words such as “anticipate,” “believe,” “may,” “will,” “continue,” “seek,” “estimate,” “intend,” “hope,” “predict,” “could,” “should,” “would,” “project,” “plan,” “expect” or the plural of these words or similar expressions, although not all forward-looking statements contain these words. Factors or risks that could cause our actual results to differ from the results we anticipate include, but are not limited to:

- our financial performance and our ability to achieve or sustain profitability or predict future results;
- our ability to attract and retain customers;
- our ability to deliver high-quality customer service;
- the growth of demand for enterprise work management applications;
- our ability to effectively manage our growth;
- our ability to consummate and integrate acquisitions;
- maintaining our senior management team and key personnel;
- our ability to maintain and expand our direct sales organization;
- our ability to obtain financing in the future on acceptable terms or at all;
- our ability to adapt to changing market conditions and competition;
- our ability to successfully enter new markets and manage our international expansion;
- the operation and reliability of our third-party data centers and hosting providers;
- our ability to manage our consultants and contractors;
- our ability to adapt to technological change and continue to innovate;
- economic and financial conditions;
- our ability to integrate our applications with other software applications;
- maintaining and expanding our relationships with third parties;
- costs associated with defending intellectual property infringement and other claims;
- our ability to maintain, protect and enhance our brand and intellectual property;
- our ability to comply with privacy laws and regulations; and

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other risk factors included under “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 30, 2016, as updated by this Quarterly Report on Form 10-Q.

The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from our forward-looking statements, including those factors discussed in Part I: “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 30, 2016, as updated by Part II, Item 1A: “Risk Factors” of this Quarterly Report on Form 10-Q and other risks and uncertainties detailed in this and our other reports and filings with the SEC. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We anticipate that subsequent events and developments may cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely on these forward-looking statements as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.

Overview

Upland is a leading provider of cloud-based enterprise work management software. We define enterprise work management software as software applications that enable organizations to plan, manage and execute projects and work. Our family of applications enables users to manage their projects, professional workforce and IT investments, automate document-intensive business processes and effectively engage with their customers, prospects and community via the web and mobile technologies.

Our applications are easy-to-use, highly scalable and offer real-time collaboration for knowledge workers distributed on a local or global scale. Our applications address enterprise work challenges in the following categories:

• **Project and Information Technology (IT) Financial Management.** Enables customers to manage their organization’s projects, professional workforce and IT costs.

• **Workflow Automation.** Enables customers to automate document-intensive workflows among internal functional areas as well as with their partners and supply chain.

• **Digital Engagement.** Enables customers to effectively engage with their customers, prospects and community via the web and mobile technologies.

We sell our software applications primarily through a direct sales organization comprised of inside sales and field sales personnel. In addition to our direct sales organization, we have an indirect sales organization, which sells to distributors and value-added resellers. We employ a land-and-expand go-to-market strategy. After we demonstrate the value of an initial application to an organization, our sales and account management teams work to expand the adoption of that application across the organization. Our customer success organization supports our direct sales efforts by managing the post-sale customer lifecycle. We refer to our customer relationships representing greater than \$25,000 in annualized recurring revenue as major customers and expansions with respect to a single customer of greater than \$25,000 in annualized recurring revenue as major expansions.

Our subscription agreements are typically sold either on a per-seat basis or on a minimum contracted volume basis with overage fees, depending on the application being sold. We service customers ranging from large global corporations and government agencies to small- and medium-sized businesses. We have more than 2,000 customers with over 235,000