Shutterstock, Inc.
Form 10-Q
August 08, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

or

o 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: 001-35669

SHUTTERSTOCK, INC.

(Exact name of registrant as specified in its charter)

Delaware	**80-0812659**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Jonathan Oringer

Chief Executive Officer

Shutterstock, Inc.

350 Fifth Avenue, 21st Floor

New York, NY 10118

(Address of principal executive offices, including zip code)

(646) 419-4452

(Registrant s telephone number, including area code)

Indicate by check mark whether 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. x Yes o 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). x Yes o 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 o	Accelerated filer x

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

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

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

Class	Outstanding at August 6, 2014
Common Stock, $0.01 par value per share	**35,337,200**

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology such as believe, may, estimate, continue, anticipate, intend, expect, predict, potential , project, guidance, target, forecast

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends affecting the financial condition of our business. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made and/or management s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements as a result of certain factors, as more fully described in Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q and in the reports and documents filed from time to time by us with the Securities and Exchange Commission (the SEC).

Forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

WHERE YOU CAN FIND MORE INFORMATION

Shutterstock s corporate website is located at *www.shutterstock.com* . Shutterstock makes available free of charge, on our corporate website, our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing to, the SEC. Information contained on Shutterstock s corporate website is not part of this report or any other report filed with the SEC.

Unless the context otherwise indicates, references in this report to the terms Shutterstock, the Company, we, our and us refer to Shutterstock, Inc. and its subsidiaries.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

Shutterstock, Inc.

Consolidated Balance Sheets

(In thousands, except par value amount)

(unaudited)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 180,851	$ 155,355
Short-term investments	54,997	54,429
Credit card receivables	2,898	2,083
Accounts receivable, net	11,119	6,081
Prepaid expenses and other current assets	19,819	19,809
Deferred tax assets, net	4,340	5,431
Total current assets	274,024	243,188
Property and equipment, net	27,575	20,256
Intangible assets, net	4,546	853
Goodwill	10,186	1,423
Deferred tax assets, net	15,097	10,720
Other assets	1,891	2,048
Total assets	$ 333,319	$ 278,488
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,483	$ 4,164
Accrued expenses	22,473	23,638
Contributor royalties payable	10,845	9,180
Deferred revenue	66,437	52,100
Other liabilities	822	2,846
Total current liabilities	106,060	91,928
Other non-current liabilities	11,794	3,961
Total liabilities	117,854	95,889
Commitments and contingencies (Note 9)		
Stockholders equity:		
Common stock, $0.01 par value; 200,000 shares authorized; 35,334 and 35,071 shares outstanding as of June 30, 2014 and December 31, 2013, respectively	353	351
Additional paid-in capital	150,495	127,443
Accumulated comprehensive income	44	9
Retained earnings	64,573	54,796
Total stockholders equity	215,465	182,599

Total liabilities and stockholders equity	$	333,319	$	278,488

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.

Consolidated Statements of Operations

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

(unaudited)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenue	$ 80,238	$ 56,809	$ 153,016	$ 107,926
Operating expenses:				
Cost of revenue	32,047	21,768	61,159	41,589
Sales and marketing	20,492	13,314	39,768	25,292
Product development	9,275	5,060	17,052	9,615
General and administrative	9,994	5,734	17,508	10,514
Total operating expenses	71,808	45,876	135,487	87,010
Income from operations	8,430	10,933	17,529	20,916
Other (expense) income, net	(19)	20	2	8
Income before income taxes	8,411	10,953	17,531	20,924
Provision for income taxes	3,550	4,090	7,753	8,496
Net income	$ 4,861	$ 6,863	$ 9,778	$ 12,428
Less:				
Undistributed earnings to participating stockholder	10	22	21	41
Net income available to common stockholders	$ 4,851	$ 6,841	$ 9,757	$ 12,387
Net income per basic share available to common stockholders:				
Undistributed	$ 0.14	$ 0.20	$ 0.28	$ 0.37
Basic	$ 0.14	$ 0.20	$ 0.28	$ 0.37
Net income per diluted share available to common stockholders:				
Undistributed	$ 0.14	$ 0.20	$ 0.27	$ 0.37
Diluted	$ 0.14	$ 0.20	$ 0.27	$ 0.37
Weighted average shares outstanding:				
Basic	35,148,876	33,471,679	35,089,254	33,435,439
Diluted	35,874,789	34,040,934	35,857,899	33,903,898

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.

Consolidated Statements of Comprehensive Income

(In thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 4,861	$ 6,863	$ 9,778	$ 12,428
Foreign currency translation gain	18		19	
Unrealized gain on investments	15		16	
Other comprehensive income	33		35	
Comprehensive income	$ 4,894	$ 6,863	$ 9,813	$ 12,428

See Notes to Unaudited Consolidated Financial Statements

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Shutterstock, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 9,778	$ 12,428
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,632	1,725
Write-off of property and equipment	367	
Deferred taxes	(2,474)	(3,127)
Non-cash equity-based compensation	9,393	2,570
Change in fair value of contingent consideration	40	
Excess tax benefit from the exercise of stock options	(8,721)	(1,009)
Bad debt reserve	189	244
Chargeback and sales refund reserves	105	20
Amortization of deferred financing fees		125
Changes in operating assets and liabilities:		
Credit card receivables	(815)	(1,069)
Accounts receivable	(5,227)	(2,941)
Prepaid expenses and other current and non-current assets	8,963	(3,748)
Accounts payable and other current and non-current liabilities	6,638	2,636
Contributor royalties payable	1,665	1,158
Deferred revenue	13,254	8,802
Net cash provided by operating activities	$ 36,787	$ 17,814
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(14,780)	(2,986)
Purchase of investments	(141,788)	
Sale and maturities of investments	141,235	
Acquisition of business	(10,056)	
Security deposit payment	(76)	(1,791)
Net cash used in investing activities	$ (25,465)	$ (4,777)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	4,486	1,616
Proceeds from issuance of common stock under Employee Stock Purchase Plan	945	1,065
Excess tax benefit from the exercise of stock options	8,721	1,009
Payment of term loan		(6,000)
Payment of offering fees		(20)
Net cash provided by (used in) financing activities	$ 14,152	$ (2,330)
Effect of foreign exchange rates changes on cash	22	
Net increase in cash and cash equivalents	25,496	10,707
Cash and cash equivalents Beginning	155,355	102,096
Cash and cash equivalents Ending	$ 180,851	$ 112,803
Supplemental Disclosure of Cash Information:		
Cash paid for:		
Income taxes	$ 159	$ 14,194

Interest	$		$	34
Supplemental Disclosure of Non-Cash Investing and Financing Activities:				
Capital expenditures in accounts payable and other liabilities	$	936	$	

See Notes to Unaudited Consolidated Financial Statements.

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Shutterstock, Inc.

Notes to Unaudited Consolidated Financial Statements

(In thousands, except share and per share data)

(1) Summary of Operations and Significant Accounting Policies

Summary of Operations

Shutterstock, Inc. (the Company or Shutterstock) operates an industry-leading global marketplace for commercial digital imagery and music. Commercial digital imagery consists of licensed photographs, illustrations and videos that companies use in their visual communications, such as websites, digital and print marketing materials, corporate communications, books, publications and video content while music consists of high-quality music tracks often used to complement the digital imagery. The Company licenses commercial digital imagery and music to its customers. Contributors upload their digital imagery and music tracks to the Company s website in exchange for a royalty payment based on customer download activity. The Company is headquartered in New York City with offices in Berlin, Chicago, Denver, London, Paris, and San Francisco.

Principles of Consolidation

The consolidated financial statements reflect the operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Reorganization

In May 2012, in connection with the filing of a registration statement for the Company s initial public offering (the IPO), Shutterstock Images LLC, a New York limited liability company (the LLC) formed Shutterstock, Inc., a Delaware corporation, as a wholly-owned subsidiary of the LLC. On October 5, 2012, the LLC reorganized, by way of a merger of the LLC with and into Shutterstock, Inc. with Shutterstock, Inc. surviving in the merger (the Reorganization). In connection with the Reorganization, the preferred and common membership interests in the LLC, including any interests that vested upon the Reorganization, were exchanged for an aggregate of 28,338,281 shares of Shutterstock, Inc. common stock.

Unaudited Interim Financial Statements

The interim consolidated balance sheet as of June 30, 2014, the consolidated statements of operations, comprehensive income and cash flows for the three and six months ended June 30, 2014 and 2013 are unaudited. The unaudited interim financial statements have been prepared on a basis consistent with the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company s financial position as of June 30, 2014 and its results of consolidated operations, comprehensive income and cash flows for the three and six months ended June 30, 2014 and 2013. The financial data and the other financial information disclosed in these notes to the financial statements related to these periods are also unaudited. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the year ending December 31, 2014 or for any other future annual or interim period.

There have been no material changes in the significant accounting policies from those that were disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed on February 28, 2014. These financial statements should also be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2013. Certain information and note disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been omitted pursuant to such rules and regulations. The consolidated balance sheet as of December 31, 2013 included herein was derived from the audited financial statements as of that date, but does not include all disclosures required by GAAP.

Acquisition of Virtual Moment, LLC

On March 14, 2014, the Company acquired certain assets and certain liabilities of Virtual Moment, LLC (dba WebDAM) (WebDAM) pursuant to an asset purchase arrangement. The transaction was accounted for using the acquisition method, and accordingly, the results of the acquired business have been included in the Company s results of operations from the acquisition date.

WebDAM sells digital asset management software services through its cloud-based platform to marketing and creative enterprise organizations. WebDAM s products help organizations manage, search, distribute and collaborate on creative digital files in order to grow its brands and reach new audiences. WebDAM s offerings are particularly attractive to large enterprises, which make up a significant portion of their client base. The Company believes that this acquisition will strengthen its strategic position with its enterprise customers as well as broaden its product offerings to larger companies.

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The fair value of consideration transferred in this business combination was allocated to the intangible assets acquired and liabilities assumed at the acquisition date, with the remaining unallocated amount recorded as goodwill. The allocation of the purchase price for this acquisition has been prepared on a preliminary basis, and changes to those allocations may occur as additional information becomes available.

The total purchase price of $12,416 consists of an initial cash payment of $10,056 and $2,360 in contingent consideration based on certain performance criteria of post-acquisition revenue. The fair value of the contingent consideration was determined using a Monte-Carlo simulation approach. The aggregate purchase price was allocated to the assets acquired and liabilities assumed as follows:

Intangible assets:		
Trade name	$	500
Customer relationships		2,800
Developed technology		600
Goodwill		8,763
Total assets acquired		836
Total liabilities assumed		(1,083)
Total	$	12,416

The identifiable intangible assets have a weighted average life of approximately seven years and are being amortized on a straight-line basis. The fair value of the customer relationships was determined using a variation of the income approach known as excess earnings method. The fair values of the trade name and developed technology were both determined using the relief-from-royalty method. The goodwill arising from the transaction is primarily attributable to expected operational synergies and is deductible for income tax purposes. As a result of the acquisition, the Company recorded approximately $400 of professional fees for the six months ended June 30, 2014 which is included in general and administrative expense. There were no professional fees as a result of the acquisition recorded during the three months ended June 30, 2014.

Pro forma results of operations have not been presented because the effect of this business combination was not material to the Company s consolidated results of operations.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires the Company s management to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. The Company evaluates its significant estimates on an ongoing basis, including, but not limited to allowance for doubtful accounts, contingent consideration, sales refund reserve, goodwill, intangibles, non-cash equity-based compensation, income tax provision and for certain non-income tax accruals. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

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Restricted Cash

The Company s restricted cash relates to security deposits for leased office locations. As of June 30, 2014, the Company had $431 of restricted cash recorded in prepaid expenses and other current assets that related to a leased office location that expires in the next twelve months and had $1,829 of restricted cash recorded in other assets that related to a leased office location that expires in 2024. As of December 31, 2013, the Company had $243 of restricted cash recorded in prepaid expenses and other current assets and had $2,017 of restricted cash recorded in other assets. The carrying value of restricted cash approximates fair value.

Deferred Rent

The Company records rent expense on a straight-line basis over the term of the related lease. The difference between the rent expense recognized and the actual payments made in accordance with the lease agreement is recognized as a deferred rent liability on the Company s balance sheet. As of June 30, 2014, the Company has recorded a deferred rent balance of and $7,470, of which $250 is included in other liabilities and $7,220 is included in other non-current liabilities. As of December 31, 2013, the Company had recorded a deferred rent balance of $4,783, of which $2,406 is included in other liabilities and $2,377 is included in other non-current liabilities.

Revenue Recognition

The vast majority of the Company s revenue, net of chargebacks and refunds, is generated from the license of digital content through subscription or usage based plans. The Company s three primary plans are: subscription plans, On Demand plans, and credit pack plans. The Company recognizes revenue when all of the following basic criteria are met: there is persuasive evidence of an arrangement, performance or delivery of services has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The Company considers persuasive evidence of an arrangement to be an electronic order form, or a signed contract, which contains the fixed pricing terms. Performance or delivery is considered to have occurred upon the ratable passage of time for subscription plans, the download of digital content or the expiration of a contract period for which there are unused downloads or credits. Collectability is reasonably assured since most of the Company s customers purchase products by making electronic payments at the time of a transaction with a credit card. The Company establishes a chargeback allowance and sales refund reserve allowance based on factors surrounding historical credit card chargeback trends, historical sales refund trends and other information. As of June 30, 2014 and December 31, 2013, the Company has recorded a combined chargeback allowance and sales refund allowance of $530 and $425, respectively, which is included in other liabilities. Collectability is assessed for customers who pay on credit based on a credit evaluation for new customers, when necessary, and transaction history with existing customers. Any cash received in advance of revenue recognition is recorded as deferred revenue.

Subscription plans range in length from thirty days to one year. Subscription plan revenues are recognized on a straight-line basis using a daily convention method over the plan term. On Demand plans are typically for a one-year term and permit the customer to download up to a fixed amount of digital content. On Demand revenues are recognized at the time the customer downloads the digital content on a per unit basis. Revenue related to unused digital content, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Credit pack plans are generally for a one-year term and enable the customer to purchase a fixed number of credits which can then be utilized to pay for downloaded digital content. The number of credits utilized for each download depends on the digital content size and format. Credit pack revenue is recognized based on customer usage on a per credit basis as digital content is downloaded. Revenue related to unused credits, if any, is recognized in full at the end of the plan term assuming no further Company obligation remains. Most plans automatically renew at the end of the plan term unless the customer elects not to renew. The Company recognizes revenue from its three types of plans on a gross basis in accordance with the authoritative guidance on principal-agent considerations as the Company is the primary obligor in the arrangement, has control in establishing the product s price, performs a detailed review of the digital content before accepting it to its collection to ensure it is of high quality before it may be purchased by the customers, can reject contributor s images in its sole discretion, and has credit risk.

Customers typically pay in advance (or upon commencement of the term) via credit card, wire or check. Fees paid or invoiced in advance are deferred and recognized as described above. Customers that do not pay in advance are invoiced and are required to make payment under standard credit terms. The Company does not generally offer refunds or the right of return to customers. There are situations in which a customer may receive a refund but the determination is made on a case-by-case basis.

The Company licenses digital content to customers through third party resellers. The Company contracts with third party resellers around the world to access markets where the Company does not have a significant presence. Third party resellers sell the Company s products directly to end-user customers and remit a fixed amount to the Company based on the type of plan sold. The terms of the reseller program indicate that the third party reseller is the primary obligor to the end-user customer and bears the risks and rewards as principal in the transaction. In assessing whether the Company s revenue should be reported on a gross or net basis with respect to our reseller program, the Company follows the authoritative guidance in ASC 605-45, Principal Agent Considerations. The Company recognizes revenue net of reseller commission in accordance with the type of plan sold, consistent with the plan descriptions above. The Company generally does not offer refunds or the right of return to resellers.

The Company also generates revenue related to WebDAM from licensing its hosted software services through its cloud-based platform and related implementation and professional services. The Company enters into multiple element revenue arrangements in which a customer purchases a combination of hosted software, implementation and optional value added professional services. The Company recognizes revenue for the hosted services monthly provided that there is persuasive evidence of an arrangement, the service has been delivered, the fees are fixed and determinable, and collection is reasonably assured. ASC 605-25 establishes a selling price hierarchy for determining the selling price of a deliverable in multiple-element arrangements, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) best estimated selling price. The hosted software services are recognized ratably over the contractual period as this service is on-going over the hosting period which is generally a one-year term. The Company defers revenue for the delivered elements until the undelivered element is delivered and then recognizes the delivered element revenue ratably over the longer of the contractual term or the estimated customer relationship period which is currently three years.

Equity-Based Compensation

The Company measures and recognizes non-cash equity-based compensation expense for all equity-based payment awards made to employees based on estimated fair values. The value portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period. For awards with a change of control condition, an evaluation is made at the grant date and

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future periods as to the likelihood of the condition being met. Compensation expense is adjusted in future periods for subsequent changes in the expected outcome of the change of control conditions until the vesting date. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense related to awards with a market condition is recognized regardless of the achievement of the market condition provided the requisite service period is met.

The Company uses the Black Scholes option pricing model, the closing price of the Company s common stock on the date of grant, and the Monte Carlo simulation model, if the award has a market condition, to determine the fair value of stock options and restricted stock units (RSUs), respectively, granted pursuant to the Value Appreciation Rights Plan (VAR Plan), 2012 Omnibus Equity Incentive Plan (the 2012 Plan) and stock purchased pursuant to the Employee Stock Purchase Plan (2012 ESPP), which are discussed further in Note 11, Equity-Based Compensation.

The determination of the grant date fair value using an option-pricing model and simulation model requires judgment as well as assumptions regarding a number of other complex and subjective variables. These variables include the Company s fair value of the common ownership interest pre-IPO, the Company s closing market price at the grant date post-IPO, the expected unit price volatility over the expected term of the awards, awards exercise and cancellation behaviors, risk-free interest rates, and expected dividends, which are estimated as follows:

- ***Fair Value of Common Membership Unit.*** Prior to completion of the IPO, the Company s fair value of common ownership interest was estimated internally and approved by the Board of Managers (BOM) because the Company was not publicly traded. The Company s intention upon granting VAR Plan awards was for the granted award to have exercisable price per unit that was not less than the per unit fair value of the Company s common equity on the date of grant. The valuations of the Company s common equity unit were prepared in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services 1: *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. The assumptions used in the valuation model were based on future expectations combined with the Company s judgment. In the absence of a public trading market, the Company exercised significant judgment and considered numerous objective and subjective factors to determine the fair value of the common equity unit as of the date of each VAR Plan award grant. Some but not all of these factors included operating and financial performance, current business conditions and projections, the hiring of key personnel, the Company s history and introduction of new functionality and services, the Company s stage of development, the likelihood of achieving a liquidity event for the common ownership interests, any adjustment necessary to recognize a lack of marketability for the common ownership interests, the market performance of comparable publicly traded companies, and U.S. and global capital market conditions. The Company also obtained independent third party valuations on a periodic basis. After October 11, 2012, the date the Company s common stock began trading on the NYSE, the grant date fair value for stock-based awards is based on the closing price of the Company s common stock on the NYSE on the date of grant and fair value for all other purposes related to stock-based awards shall be the closing price of the Company s common stock on the NYSE on the relevant date.

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- ***Expected Term.*** The expected term is estimated using the simplified method allowed under Securities and Exchange Commission (SEC) guidance.

- ***Volatility.*** As the Company does not have a trading history for its common ownership interest pre-IPO or a significant range of its common stock post-IPO, the expected price volatility for the common ownership interest and common stock was estimated by taking the average historic price volatility for industry peers based on daily price observations over a period equivalent to the expected term of the VAR Plan awards and stock options granted post-IPO. Industry peers consist of several public companies similar in size, stage of life cycle and financial leverage. The Company did not rely on implied volatilities of traded options in the industry peers common stock because the volume of activity was relatively low. The Company intends to continue to consistently apply this process using the same or similar public companies until a sufficient amount of historical information regarding the volatility of the Company s own common stock becomes available, or unless circumstances change such that the identified companies are no longer similar to the Company, in which case, more suitable companies whose share prices are publicly available would be utilized in the calculation.

- ***Risk-free Interest Rate.*** The risk-free interest rate is based on the yields of U.S. Treasury securities with maturities similar to the expected term of each award group.

- ***Dividend Yield.*** Prior to the Reorganization, the Company has historically paid cash dividends or distributions to its members. Following the Reorganization, the Company has not paid cash distributions to its stockholders and it does not intend to do so for the foreseeable future. As a result, the Company used an expected dividend yield of zero.

If any of the assumptions used in the Black-Scholes pricing model or Monte Carlo simulation model changes significantly, the fair value for future awards may differ materially compared with the awards granted previously. The awards granted pursuant to the VAR Plan, the 2012 Plan, and the 2012 ESPP are subject to a time-based vesting requirement and for certain award grants are also based on a market condition. The majority of stock option awards granted under the 2012 Plan vest over four years while the majority of the restricted stock units granted under the 2012 Plan vest over three years. The 2012 ESPP provides for purchase periods approximately every six months and a participant must be employed on the purchase date to participate. The VAR Plan awards had a condition that a change of control (as defined in the VAR Plan) must occur for a payment to trigger with respect to the VAR Plan awards. In connection with the Company s Reorganization, all of the VAR Plan awards were exchanged for options to purchase shares of common stock of Shutterstock, Inc. As of December 31, 2011, no equity-based compensation expense had been recognized with respect to the VAR Plan awards because the qualifying event had not occurred. As a result of the completion of the initial public offering (IPO) in October 2012, the Company began recording stock-based compensation expense using the accelerated attribution method, net of forfeitures, based on the grant date fair value of the VAR Plan awards that were exchanged for options to purchase shares of common stock of Shutterstock, Inc. as part of the Company s Reorganization.

For pre-IPO equity based awards that qualified for liability classification, the Company has elected to use the intrinsic value method to value the common membership interest in accordance with authoritative guidance on stock compensation. See Note 11, Equity-Based Compensation, for further information.

Income Taxes

The Company is a Delaware corporation and is therefore subject to federal and state income tax. Significant management judgment is required in projecting ordinary income/(loss) in order to determine the Company s estimated effective tax rate.

The Company accounts for unrecognized tax benefits using a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes may be due. The Company records an income tax liability, if any, for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on the Company s tax returns. To the extent that the assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. The reserves are adjusted in light of changing facts and circumstances, such as the outcome of a tax audit or lapses in statutes of limitations. Any reserve for uncertain tax provisions, if any, and related penalties and interest, if any, are included in the income tax provision.

The Company assessed the realizability of deferred tax assets and determined that based on the available evidence, including a history of taxable income and estimates of future taxable income, it is more likely than not that the deferred tax assets will be realized. The Company will continue to evaluate its ability to realize deferred tax assets on a quarterly basis. Significant management judgment is required in determining the provision for income taxes and deferred tax assets and liabilities. In the event that actual results differ from these estimates, the Company will adjust these estimates in future periods which may result in a change in the effective tax rate in a future period.

The Company is subject to compliance requirements for certain non income taxes, including value added taxes, sales taxes and royalty withholding taxes. Where appropriate, the Company has made accruals for these taxes, which are reflected in the Company s consolidated financial statements.

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Net Income Per Share

Basic net income per share is computed by dividing the net income attributable to common stockholders by the weighted average number of common shares outstanding during the period. The Company applies the two class method for calculating and presenting income per share. Under the two-class method, net income is allocated between shares of common stock and other participating securities based on their contractual participating rights to share in the earnings as if all of the earnings for the period have been distributed. Participating securities are defined as securities that participate in dividends with common stock according to a pre-determined formula or a contractual obligation to share in the income of the entity. Any potential issuance of common shares, including those that are contingent and do not participate in dividends, are excluded from weighted average number of common shares outstanding. Undistributed net income (loss) for a given period is apportioned to participating stockholders based on the weighted average number of shares for each class of securities outstanding during the applicable period as a percentage of the combined weighted average number of these securities outstanding during the period. Income available to common stockholders is computed by deducting dividends paid to preferred stockholders, accretion to redemption value on preferred members shares, less income allocated to participating securities including unvested shares for the restricted award holder since these unvested shares have participating rights. See Note 11, Equity-Based Compensation, for further discussion.

Diluted net income per share is computed by dividing the net income available to common stockholders adjusted for any changes in income that would result from the assumed conversion of the potential common shares by the weighted average common shares outstanding and all potential common shares, if they are dilutive. Diluted net income available to common stockholders for the three and six months ended June 30, 2014 includes the effect of 2,258,623 and 2,173,402 shares, respectively, while 621,799 and 400,842 shares, respectively, were excluded since they were anti-dilutive. Diluted net income available to common stockholders for the three and six months ended June 30, 2013 includes the effect of 1,716,301 and 1,776,776 shares, respectively, while 257,800 and 155,775 shares, respectively, were excluded since they were anti-dilutive.

A reconciliation of assumed exercised shares used in calculating basic and diluted net income per share available to common stockholders follows:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2014	**2013**	**2014**	**2013**
Basic	35,148,876	33,471,679	35,089,254	33,435,439
Stock options and employee stock purchase plan shares	625,273	523,613	665,628	440,345
Unvested restricted stock awards	100,640	45,642	103,017	28,114
Diluted	35,874,789	34,040,934	35,857,899	33,903,898

Recently Issued Accounting Standard Updates

In May 2014, the Financial Accounting Standards Board (FASB) issued new accounting guidance related to revenue recognition. This new standard will replace all current GAAP guidance on this topic and will eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is evaluating the impact, if any, of adopting this new accounting standard on its financial statements.

In June 2014, the FASB issued new guidance related to stock compensation. The new standard requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and can be applied either prospectively or retrospectively to all awards outstanding as of the beginning of the earliest annual period presented as an adjustment to opening retained earnings. Early adoption is permitted. The Company is evaluating the impact, if any, of adopting this new accounting standard on its financial statements.

(2) Short Term Investments and Fair Value Measurements

Short term investments are summarized as follows:

	As of June 30, 2014			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Market Value**
Commercial paper	$ 55,000	$	$ (3)	$ 54,997
Total	$ 55,000	$	$ (3)	$ 54,997

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	As of December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Market Value
Commercial paper	$ 54,431	$	$ (2)	$ 54,429